



U.S. Customs Service



A m e r i c a ' s F r o n t l i n e

P e r f o r m a n c e a n d A n n u a l R e p o r t F i s c a l Y e a r 2 0 0 2



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This Performance and Annual Report covers Federal Fiscal Year (FY) 2002 (October 1, 2001, through September 30, 2002) with discussion of some subsequent events. It is prepared under the requirements of the Reports Consolidation Act of 2000. The purpose of the Act is to streamline and consolidate statutory financial management and performance reporting requirements into a single report.

This report highlights Customs strategic initiatives, performance goals, mission accomplishments, and presents related financial management information that represents an on-going effort to provide useful information to internal and external customers. The figures shown for FY 2002 program operations and performance measures in the Management Discussion and Analysis Section of the report are those that were available as of October 31, 2002. Customs financial statements provide the financial position and results of Customs operations, pursuant to the requirements of 31 U.S.C.

While the statements have been prepared from Customs books and records in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements are supplemental to the financial reports used to monitor and control budgetary resources prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government. One implication of this is that unfunded liabilities cannot be liquidated without legislation that provides the resources for that purpose.

Information about Customs programs is available through the Internet on Customs Home Page at <http://www.customs.treas.gov>. The Customs Home Page is updated on an on-going basis with current information relating to the Customs mission, and the programs and initiatives designed to carry it out.

FROM THE COMMISSIONER



This past year has been one of the most challenging in our nation's history, as well as one of the most challenging in the 213-year history of the United States Customs Service (Customs). Because of Customs responsibilities at our nation's borders – land borders, seaports, international airports – our nation called on Customs to put a priority on a mission of the utmost importance – protecting America against the threat of international terrorism.

Combating terrorism is the number one priority of Customs, and it will continue to be our number one priority for the foreseeable future. We are doing everything we reasonably and responsibly can to keep terrorists and terrorist weapons out of our country.

Customs has not, however, lost sight of our other traditional responsibilities, such as facilitating the legitimate trade and commerce so crucial to our nation's economy, defending our country from the scourge of illegal drugs, defending children from predators that roam the Internet, and developing and using the world-class tools and technology that will further our mission. As this FY 2002 Performance and Annual Report shows, Customs continues to address these responsibilities with the same vigor, determination, and skill we have always demonstrated.

On the drug interdiction front, Customs had an outstanding year. In addition to maintaining its seizures of large quantities of cocaine and marijuana, Customs seizures of heroin and ecstasy increased by approximately 6 percent and 4 percent, respectively, compared to FY 2001 levels. But we have done more than just seize large amounts of illegal drugs. Customs has conducted follow-up investigations that have identified and led to the prosecution of key members of drug smuggling and money laundering organizations.

Meanwhile, trade entries – the number of individual commercial transactions processed by Customs – increased from 23.7 million entries in FY 2001 to 24.9 million. This increase illustrates the continued rising trend in our commercial workload.

Customs stands ready to meet the challenges we face from our still expanding workload, even as we continue to bolster our efforts to protect America from international terrorism. Customs will keep delivering to the American people the outstanding results in organizational management, accountability, and mission performance that they have come to expect from our agency.

As an agency, Customs has demonstrated a remarkable ability to evolve to meet our nation's needs. And we have done this – and will continue to do this – while maintaining the reputation for excellence that is the hallmark of America's oldest law enforcement agency.

A handwritten signature in black ink, reading "Robert C. Bonner". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Robert C. Bonner

FROM THE CHIEF FINANCIAL OFFICER

On December 2, 2002, I assumed the duties of Acting Chief Financial Officer (CFO). During FY 2002 I served in my permanent position as Executive Director of Administration, Planning, and Policy for Customs Office of Investigations. There I experienced first hand the impact that September 11th had on Customs mission and day-to-day operations. Resources – operational and support alike – were stretched beyond any point in Customs history. While Customs front-line officers worked tirelessly to protect our borders, Customs mission support personnel devoted themselves to increasing front line staffing and equipping Customs officers with the necessary tools and resources. The nation should be very proud of the dedication and determination of Customs employees. I am certainly proud to serve among them.

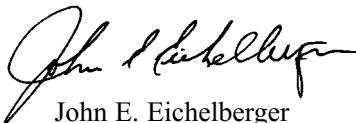


This Fiscal Year 2002 Annual Report provides an opportunity for Customs to detail the actions taken over the last year in meeting its many challenges and rapidly evolving to its key role in the security of the nation while facilitating the free flow of trade. The report also affords the Office of Finance the opportunity to elaborate on actions taken to improve financial management performance and enhance the daily support we provide to the operational elements of the Customs Service, as well as to review areas where improvement can be made in our operations. Having received six consecutive unqualified audit opinions in the years 1995 through 2000, the Department of the Treasury requested and received from the Office of Management and Budget (OMB) in Fiscal Years 2001 and 2002 waivers to exempt Customs from the requirement to perform a full-scope audit of its financial statements. Our effort this year has focused on an in-depth review of our internal controls and their effectiveness in ensuring financial integrity through this period of unparalleled stress on the organization.

For Customs, as for the nation, Fiscal Year 2002 began on a tragic note with an unprecedented sense of emergency in response to the terrorist attacks of September 11, 2001. Affected at the heart of our operations was New York City, yet within 3 days of the attack all our New York employees previously housed at 6 World Trade Center were working from alternative locations. Immediately after the disaster, Commissioner Bonner directed significant changes in Customs operational priorities. Resources were shifted to quickly implement new programs, to conduct operations effectively without interruption at the highest levels of alert, and to sustain funding for national security objectives. The Office of Finance responded by developing anti-terrorism and recovery supplemental funding requests and implementing a financial plan for the rapid and effective allocation of over \$464 million in anti-terrorism funds. Working in partnership with the Offices of Field Operations, Investigations, Human Resources, Training and Development, and Internal Affairs, we developed new staffing plans that facilitated the recruitment and hiring of almost 1,100 new Customs employees dedicated to critical functions associated with Customs new responsibilities.

Tremendous progress was also made in Fiscal Year 2002 to continue evolving Customs into leading edge systems technology. The Office of Finance helped to secure \$300 million in appropriations and provide procurement expertise for the continued development and implementation of the Automated Commercial Environment (ACE). When fully implemented, ACE will replace Customs Automated Commercial System (ACS) and serve as a state of the art platform for fully integrated information management across all Customs operations. Likewise, efforts to modernize Customs financial systems continued with the implementation of the SAP/R3 first release of integrated financial management software (Real Property) and the development of plans for the second release (Procurement and Personal Property). Full implementation will remedy core financial systems weaknesses, resulting in the improved integration of our financial systems and the production of more reliable, timely financial information and statements.

The Office of Finance plays a pivotal role in obtaining, allocating, and monitoring the financial resources required for Customs to perform its increasingly complex and dynamic role in national security, law enforcement, and its partnership with the trade community. Working together with our internal and external partners, we look forward to Fiscal Year 2003 with enthusiasm and energy, and we renew our commitment to Customs role in the nation with pride, integrity, honor, and commitment.


John E. Eichelberger

MANAGEMENT DISCUSSION AND ANALYSIS



CUSTOMS AT A GLANCE



Commissioner Bonner welcomes the President to Customs facilities.

MISSION

We are the guardians of our nation's borders – America's Frontline.

We serve and protect the American public with integrity, innovation, and pride.

We enforce the laws of the United States, safeguard the revenue, and foster lawful international trade and travel.

CORE VALUES

Integrity: We know right from wrong and conduct our actions in a manner that brings honor upon the agency.

Accountability: We honestly assess our actions and take responsibility and ownership for those actions and their consequences.

Fairness: We act with civility and impartiality toward all. Our actions and our decisions are balanced, bias-free, and sensible.

Service: We engender respect and confidence by performing our duties in a competent, professional, and courteous manner.

Pride: We believe in our mission and exert the extra effort to uphold our proud tradition of service.

VITAL STATISTICS

- 20,754 Customs employees
- 300 plus ports of entry
- 24.9 million trade entries processed
- \$23.8 billion collected
- 1.55 million pounds of narcotics seized (or assisted in seizing)
- 7.5 million tablets of ecstasy seized
- 414.9 million pedestrians and passengers processed
- 130.2 million conveyances processed

CUSTOMS RESPONDS TO TERRORISM

For over two hundred years, Customs has done a great deal to promote national and international stability by protecting America from threats arising overseas and by facilitating international trade so important to the United States (U.S.) and world economies.

Customs has always been known first and foremost as the nation's preeminent border agency, "America's Frontline." For most of our history, that frontline was defined by the land borders and seaports of the United States. It now also includes all international airports and international mail and courier facilities, as well. These "border" entry points are the locations at which the majority of our 20,000 plus employees conduct their work each day, processing travelers and goods, inspecting cargo and mail, seizing illegal drugs, money and counterfeit goods, and conducting criminal investigations. Customs still intercepts smugglers on the sea and in the air, too. On September 30, 2002, there were 86 operational vessels in the Customs fleet and 135 operational aircraft.

Though we continue to devote resources to those traditional threats, our number one priority since September 11, 2001, has been combating terrorism. We are doing everything within our power to prevent terrorists and terrorist weapons from entering the United States.

Immediately following the terrorist attacks on September 11, at about 10:05 a.m., Customs went to a Level 1 alert across the country—at all border entry points. Level 1 requires sustained, intensive anti-terrorist questioning, and includes increased inspections of travelers and goods at every port of entry. On September 3, 2002, Customs adopted a new alert level system that is in line with the Homeland Security Advisory System established by the Office of Homeland Security. In this system, Alert Level Yellow (Elevated Condition) is the equivalent of Customs Level 1 alert. As a result of the continuing terrorist threat, Customs remains at Alert Level Yellow.

As part of our response to September 11, we also implemented around-the-clock coverage by at least two armed Customs officers at every Customs location, even at low volume crossings along our Northern Border. To do this on a 24-by-7 basis, and to keep trade moving at our high volume ports, we temporarily detailed about 150 Customs inspectors to



The United States and Canada have cooperated to facilitate trade across our Northern Border.

our border with Canada. Customs inspectors are, in many places, working 12 to 16 hours a day, 6 and 7 days a week, and have been doing so now for 12 months.

Customs is also heavily involved on the investigative front of the war on terrorism. We have assigned many of our special agents to the Joint Terrorism Task Forces (JTTFs) across the country and at the Strategic Information Operations Center at FBI Headquarters. At one point, almost a third of our investigative workforce, over 1,000 Customs agents, were engaged in investigations related to the terrorist attacks. That proportion has gradually declined since October 2001. We have also contributed approximately 110 Customs agents to the Federal Sky Marshal Program. In addition, we are leading the effort to freeze and seize terrorist assets and finances through Customs longstanding expertise in anti-money laundering operations.

Customs has also moved quickly to enhance the quality and quantity of advance information we receive, especially in the area of passenger processing. We promptly sought and secured legislation that made the submission of data on incoming international passengers to the Customs Advanced Passenger Information System, or "APIS," mandatory for all airlines. That law was passed in November 2001 as part of the Aviation Security Bill.

We are also working to address another critical front in the battle against terrorism, and that is the protection of our nation's trade. The Customs Trade Partnership Against Terrorism (C-TPAT) will vastly improve security along the

entire supply chain, from foreign vendors to our land borders and seaports. C-TPAT builds on past, successful security models between Customs and the trade that were designed to prevent commercial shipments from being used to smuggle illegal drugs. Under C-TPAT, companies agree to take steps to improve the security of their shipments and the security of the supply chain. In return, Customs will give those companies that adopt or have in place a program that meets security standards “fast lane” access through border crossings, seaports, and other ports of entry.

Under the Container Security Initiative (CSI), Customs is partnering with foreign governments to protect the primary system of global trade – container shipping. Customs inspectors work side-by-side with officials from our partner Customs agencies at foreign ports – at “CSI ports.” These teams target and screen high-risk containers for security inspections before the cargo is shipped to U.S. ports.

Customs is pursuing other initiatives to defend against the terrorist threat, in addition to its partnerships with the trade on C-TPAT and with foreign governments on CSI.

- We are pursuing initiatives to harden U.S. borders, and to install sensors to remotely monitor low-volume ports of entry so that these ports of entry do not have to be staffed on a “24-by-7” basis.
- We are deploying additional, existing x-ray and gamma ray inspection technology and radiation detectors used to detect terrorist weapons. This equipment improves inspection capability and efficiency.
- We have dispersed several thousand radiation detection pagers among inspectors at the borders and seaports. These devices are used to detect nuclear weapons and weapons-grade materials. Customs continues to seek out and utilize new technology to better detect weapons of mass destruction.
- We are also working with the Canadian and Mexican governments to improve information exchange and adopt benchmarked security measures to reduce the terrorist threat to the North American Continent.



Customs is working to improve the security of our international trade system.

REVISION OF CUSTOMS STRATEGIC GOALS AND PRIORITIES

On June 6, 2002, Commissioner Robert C. Bonner transmitted a statement of his revised priorities for Customs to the Department of the Treasury, in light of developments since September 11, 2001. His priority goals for Customs fall into three broad categories:

1. Border Control and Trade Facilitation

- Implement programs and initiatives to combat international terrorism. This is the highest priority of Customs.
- Change the way Customs does business with the international trade community in order to facilitate and improve the flow of trade without impairing homeland security.

2. Investigations

- Expand Customs efforts to investigate and disrupt terrorist financing through Operation Green Quest and to disrupt terrorist access to high-tech weaponry and equipment through Project Shield America.
- Increase Customs effectiveness in investigating and enforcing federal criminal laws relating to money laundering, drug trafficking, intellectual property, customs fraud, and cybercrime.

3. Managing and Modernizing

- Substantially improve management effectiveness by making the agency more efficient and responsive to programmatic objectives, eliminating all material weaknesses as expeditiously as possible, internalizing values of integrity, innovation and effectiveness, and recognizing and rewarding truly outstanding performance.

- Rapidly modernize Customs information systems to better accomplish the foregoing.

Under the Government Performance and Results Act (GPRA), the Management Discussion and Analysis (MD&A) Section of the Annual Report for a particular fiscal year is tied to the goals and objectives previously stated in an agency's strategic plan and reported in the agency's budget and performance plan. For this reason, we are continuing to structure our MD&A discussion around the strategic goals in place at the beginning of FY 2002. However, these goals are directly tied to, and can be easily subsumed under, the Commissioner's new priorities. Our border security and trade goals fit under the new border control and trade facilitation priority, and the discussion of our narcotics trafficking, criminal finance, and public protection goals relates to the new investigations priority. Finally, our management accountability goal falls under the Commissioner's new priority for better management and modernization of Customs. It is anticipated that work will commence sometime within the next year to update the Customs Strategic Plan to reflect changes to our mission structure.

CUSTOMS PLANNING PROCESS

Customs has steadily improved its planning and management processes consistent with the GPRA. Customs aligns its organizational and program structure with the requirements of the agency's customers and stakeholders, and integrates its strategic planning, budgeting, and performance measure activities. Customs has developed statements of its mission and fundamental challenges based on its programs and activities. These provide a foundation for Customs goals and objectives.

Customs mission, goals, and objectives are a product of close collaboration with customers, the Department of the Treasury, other agencies that carry out related programs, and stakeholders in the Administration and Congress. These goals and objectives are supported by the Customs budget.

Progress toward the achievement of Customs goals and objectives is described in our MD&A Sections. These sections provide the agency's detailed performance goals and accomplishments for each goal area.

Details of our planning process are available in the Customs Strategic Plan at Customs website (<http://www.customs.treas.gov/about/strat/stratplan.pdf>).

CUSTOMS STRATEGIC GOALS FOR FISCAL YEARS 2000-2005

The following goals were established in the Strategic Plan Customs submitted for 2000-2005 to satisfy the requirements of the GPRA:

Trade and Economic Growth: Stimulate and protect the economic interests of the United States by maintaining a sound trade management system that maximizes compliance with import and export laws.

Border Security: Secure our borders while facilitating the expeditious movement of international travel and commerce.

Narcotics Trafficking: Dramatically reduce the availability and flow of drugs into the United States.

Criminal Finance: Strengthen domestic and international efforts to disrupt the flow of illegal money derived from global criminal activity.

Public Protection: Contribute to a safer America by reducing civil and criminal violations associated with the enforcement of customs laws.

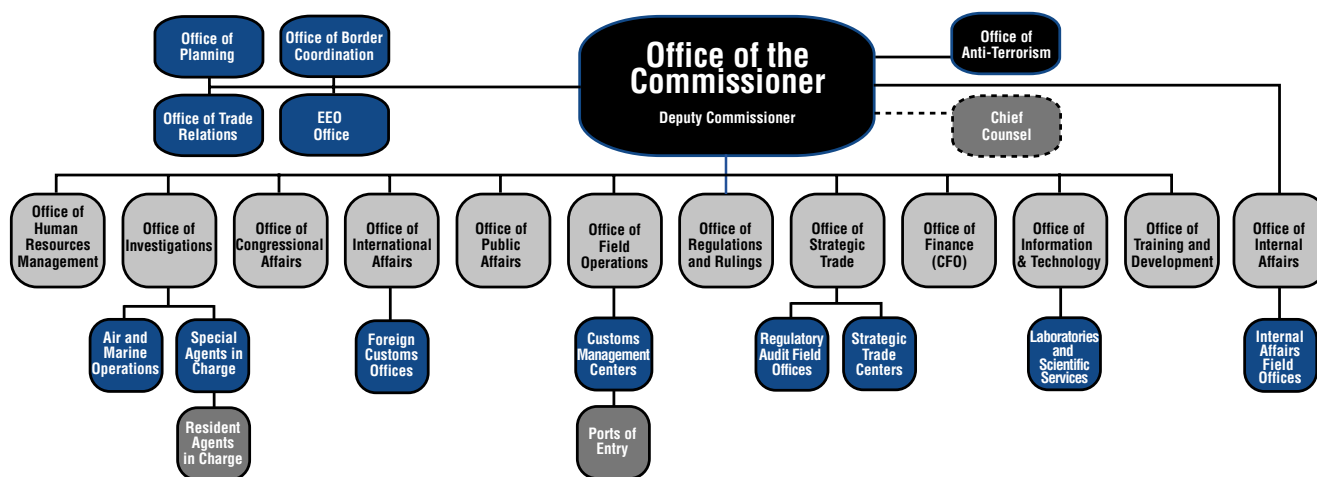
Management Accountability: Build a strong and effective management support structure that assures the achievement of business results.

AMERICA'S FRONTLINE ORGANIZATION

Headquarters

Customs FY 2002 organizational chart shows the composition of Headquarters consisting of the Office of the Commissioner and Deputy Commissioner and related staff offices, as well as the Office of Chief Counsel and the Office of Internal Affairs, seven functional offices and four crosscutting support offices each headed by an Assistant Commissioner. These offices provide effective leadership and support to Customs field personnel while maintaining their roles as advisors and policymakers in support of the Commissioner and Customs mission.

Customs is a diverse group of men and women at Headquarters and in the field dedicated to carrying out Customs mission as America's Frontline.



CUSTOMS MANAGEMENT CENTERS

The 20 Customs Management Centers (CMCs) located throughout the United States are responsible for oversight of operations within their areas of jurisdiction and exercise line authority over the ports of entry. They provide technical and operational assistance and participate in addressing the day-to-day issues at the ports located within their areas of authority. CMCs coordinate with their Office of Investigations counterparts, Special Agent-in-Charge (SAIC) offices, in executing anti-smuggling and enforcement strategies.

Ports of Entry

Ports of entry are responsible for processing conveyances, passengers, and all goods entering and exiting the United States. In addition to enforcing customs laws, these offices enforce over 400 laws for 40 other agencies involved in international commerce. Ports of entry are under the jurisdiction of CMCs. For a more detailed listing of ports of entry by state, refer to the map on the next page.

Strategic Trade Centers

Customs has five Strategic Trade Centers (STCs), located in the following areas: Los Angeles, CA; Dallas, TX; Fort Lauderdale, FL; Chicago, IL; and New York, NY. STCs are primarily responsible for monitoring trade compliance in relation to primary focus industries, and performing quantitative analyses of previous and ongoing compliance.

Investigations Field Offices

The SAIC offices are responsible for the administration and management of all enforcement activities within the geographic boundaries of their jurisdiction. The SAICs develop, coordinate, and implement enforcement strategies to ensure conformance with national policies and procedures and support national intelligence programs. Each SAIC office is responsible for any subordinate field offices which support the enforcement mission of the SAIC office. These subordinate field offices, Resident Agent-in-Charge (RAIC) and Resident Agent offices, are responsible for managing enforcement activities within their geographic boundaries.

CUSTOMS BUDGET – TRENDS AND IMPACTS

Because of Customs diverse mission, it is a major task to address the multifaceted responsibilities that help to ensure Customs addresses its greatest challenges: terrorism, stopping the inflow of drugs — as well as the inflow and outflow of other illegal contraband — while facilitating the smooth flow of international trade. Factors beyond our control have a tremendous impact on Customs workload. External factors such as trade growth, smuggling patterns, global threats, and technological change challenge our aging automated systems and our law enforcement efforts. In several prior years, increases in the Customs annual budget were minimal and staffing remained relatively static. In FY 2002, Customs received new resources for the fight against terrorism





and for ensuring the security of the nation's borders against terrorist threats. However, the struggle to achieve competing goals and develop more effective methods for carrying out Customs complex mission within available resources continues.

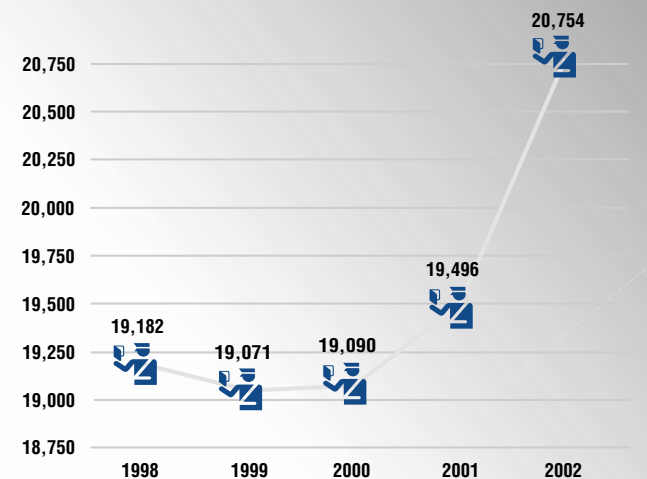
Salary and expenses (S&E) appropriations that fund Customs efforts are divided into two budget activities: "Commercial" and "Drug and Other Enforcement." Commercial activities are defined as those occurring prior to a violation being confirmed or acceptance of a referral for investigation. These activities include intelligence gathering, targeting, analysis, and examination activities. Drug and Other Enforcement activities occur after confirmation of a violation or acceptance of a referral for investigation, and include drug, money laundering, and other investigative activities.

Customs recognizes that some enforcement areas, such as narcotics smuggling and international money laundering strategies, may involve more than one strategic goal function. Customs has organized its activities to address the detection, investigation, and resolution of violations of U.S. law related to these cross-functional issues.



High tech communications are essential to Customs mission.

Total Full-Time Workforce



HOW CUSTOMS USES ITS BUDGETARY RESOURCES

The chart below presents the distribution of Customs budget resource obligations. In accomplishing its mission and in carrying out program activities, Customs spends the greatest part of its appropriated resources on S&E categories. Reimbursable Salaries and Expenses account for approximately 14 percent of the annual budget. Customs Automation Modernization Program is the third largest category with approximately 13 percent of Customs resource obligations. Through ACE and the International Trade Data System (ITDS), Customs will transform the way it does business and create an Information Technology (IT) platform to keep pace with the tremendous growth in trade and enforcement needs.

Actual Fiscal Year Budget Resource Obligations

(in millions)

	1998	1999	2000	2001	2002
Salaries and Expenses Direct (includes obligations authorized under COBRA)	\$ 1,881	\$ 2,067	\$ 2,041	\$ 2,158	\$ 2,309
Salaries and Expenses Reimbursable	439	462	542	451	519
Automation Modernization				161	476
Puerto Rico Refunds, Transfers, Expenses	110	106	96	86	87
Operations and Maintenance	169	195	177	214	206
Facilities	2	2	2	8	0
Small Airports	3	3	3	3	6
Crime Bill	55	21	65	35	8
Refunds, Transfers	8	7	5	7	6
Harbor Maintenance Fee	3	3	3	3	3
Totals	\$ 2,670	\$ 2,866	\$ 2,934	\$ 3,126	\$ 3,620



Customs employees: *Carrying Out Our Mission, Protecting Our Borders.*

PERFORMANCE GOALS AND RESULTS

GPRA requires agencies to develop and institutionalize processes to plan for and measure their mission performance. The following table presents certain goals, measures, and performance results that Customs deems critical to evaluation of its mission performance. The performance goals and results are grouped under the Customs strategic goals that they support. These are summarized below:

Performance Summary Table			
Performance Measure	Target Met Yes/No	Performance Plan	Actual
Strategic Goal: Border Security			
Secure our borders while facilitating the expeditious movement of lawful international travel and commerce			
Air Carrier Participation in APIS	No	100%	99% (9/30/02)
Compliance Measurement Exams (COMPEX) [times better than random]	Yes	Air 10X Land 11X	Air 29.1X Land 23.8X
Passenger Compliance Rate	Yes	99%	Air 98.9% Land 99.7%
Strategic Goal: Trade and Economic Growth			
Stimulate and protect the economic interests of the United States by maintaining a sound trade management system which maximizes compliance with import and export laws and moves legitimate cargo efficiently			
Trade Compliance	N/A	92%	N/A
Outbound Targeting Effectiveness	Yes	8.5%	9.4%
Strategic Goal: Narcotics Trafficking			
Dramatically reduce the amount of illegal drugs entering the United States			
Number of Cocaine Seizures	No	2,778	2,533
Pounds of Cocaine Seized (thousands)	No	200.3	167.8
Cocaine Pounds per Seizure	No	72.1	66.3
Number of Marijuana Seizures	No	15,024	13,404
Pounds of Marijuana Seized (thousands)	No	1,579.1	1,374.1
Marijuana Pounds per Seizure	No	105.1	102.5
Number of Heroin Seizures	Yes	943	967
Pounds of Heroin Seized (thousands)	Yes	3.8	4.1
Heroin Pounds per Seizure	Yes	4.0	4.3
Number of Short Landings (Air)	Yes	1,150	958
Number of No Launches (Air and Marine)	No	15.5%	30.4%
Strategic Goal: Criminal Finance			
Strengthen domestic and international efforts to disrupt the flow of illegal money derived from global criminal activities			
Value of Property Seized (millions)	Yes	\$25.5	\$36.7
Total Monetary Instruments Seized (millions)	Yes	\$95	\$274.3
Strategic Goal: Public Protection			
Contribute to a safer America by reducing terrorist, criminal, and civil activities associated with the enforcement of Customs laws			
Number of Outbound Licensing Violations	Yes	730	882

BORDER SECURITY

Goal: Secure our borders while facilitating the expeditious movement of lawful international travel and commerce.

OVERVIEW

Customs has the responsibility to ensure that all travelers entering the United States do so in compliance with federal laws and regulations. This responsibility puts Customs at the forefront of border security. Objectives in support of the border security strategic goal are to:

- Select high-risk travelers in advance of arrival.
- Deploy selectivity techniques, technology, and tools for the physical inspection of travelers' baggage and vehicles in order to mitigate potentially high-risk and destructive situations.
- Intercept high-risk travelers while expediting low-risk travelers.
- Increase travelers' awareness of Customs requirements and mission in order to achieve voluntary compliance.



Customs Vehicle and Cargo Inspection System
in operation at the border.

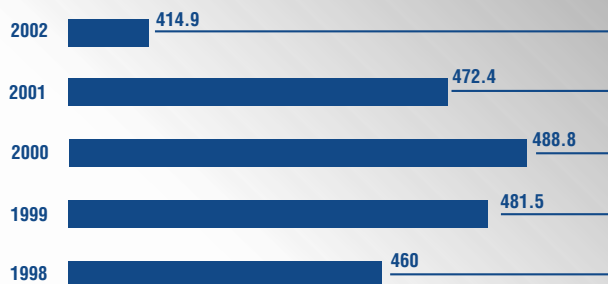
CHALLENGES

Customs has greater responsibilities at our nation's border than any other federal agency. Customs must increase the level of security against the international terrorist threat at all of the ports of entry into the United States – the Northern and Southern land borders, our seaports, and airports – while allowing the expeditious movement of legitimate travelers and trade. The continued high volumes of arriving international passengers and conveyances at our nation's borders, in an era of increased threat to homeland security, means Customs faces many challenges in the years ahead. To meet these challenges, Customs must maximize the effectiveness of its workforce, seek innovative advances in technology, and work “beyond the border” to ensure both security and the smooth flow of travelers and commerce. Customs will work with Mexico and Canada to realize the goals set forth in the Smart Border Accord, and will strive to improve border management interagency cooperation. Customs will continue the “hardening” of the northern and southern borders, working to improve the security infrastructure with the installation of security equipment and technology to ensure Customs ability to enforce our mission, meet heightened alert level requirements, and secure our nation's borders.

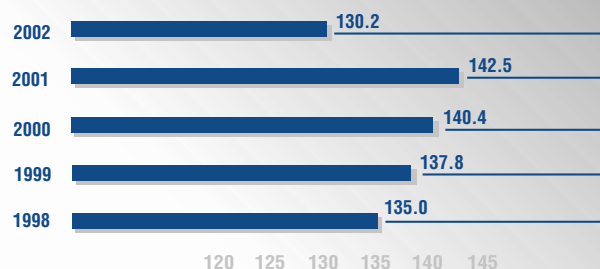
ANALYSIS OF PERFORMANCE

Passenger volume for air, land, and sea continued to show a downward trend in FY 2002 due to the impact of the events of September 11, 2001. During FY 2002, 414.9 million passengers and pedestrians were processed by Customs. Of these arriving persons, 56.9 million (plus 11.9 million pre-cleared outside the United States) arrived via commercial airlines, 12.2 million arrived by ship, and 312.4 million arrived at our land borders. The balance of arriving persons used trains, buses, and private and corporate aircraft as modes of transportation. Processed conveyances, such as passenger vehicles, trucks, private and commercial aircraft, and small boats and vessels, amounted to 130.2 million.

Land, Air, and Sea Passengers (in millions)



Conveyances (in millions)



Customs commenced implementation of hardening the northern and southern land borders with the installation of gates, signs, lights, and remote surveillance systems. Of particular concern were the ports of entry along the vast Northern Border with Canada. Customs has installed security hardware at 20 Northern Border ports of entry through the Northern Border Security Deployment Project. Expansion of this project will continue throughout FY 2003.

Performance Goal 1: Develop and refine methods to select high-risk passengers in advance of arrival (target these passengers).

Performance Measure: Air carrier participation in APIS.

A critical priority for Customs in FY 2002 was the successful implementation of the Aviation and Transportation Security Act of 2001, which made 100 percent compliance with APIS mandatory for all commercial arriving air passengers and crew beginning November 19, 2001. In order to satisfy critical national security needs for advance passenger information, Customs successfully moved APIS in a short time frame from a voluntary program to a mandatory one, through

interagency cooperation and outreach to the airline industry. Due to the efficient development and implementation of an informed and enforced compliance plan, 99 percent of all passengers and crew (including those pre-cleared) are now being transmitted in APIS.

Capitalizing on the success of the APIS compliance strategy and effective risk management methodology, Customs will focus on the continuing development of APIS, which includes outbound APIS for commercial passenger air carriers, and commercial vessel APIS for inbound and outbound passengers. Customs will continue to build the next generation of APIS with “Name by Name” query capability. This key law enforcement tool will allow a return message to air carriers to “Board/Don’t Board” the traveler in question. It will have the effect of pushing the U.S. perimeter out to the departure airport by preventing the boarding of those persons who may pose a security threat to the aircraft, and by preventing the arrival of illegal aliens.

Customs continues to develop and expand the Automated Targeting System/Passenger (ATS/P) application, the web-based computer system used to gather tactical intelligence on arriving passengers. All information is stored and available for analysis anywhere on the Customs Intranet via a web browser. ATS/P integrates various enforcement and commercial databases into a consolidated targeting platform. These databases include APIS, various federal law enforcement agency systems, and numerous airline reservation systems. The next release of ATS/P will include critical law enforcement tools such as expanded access to airline reservation systems,

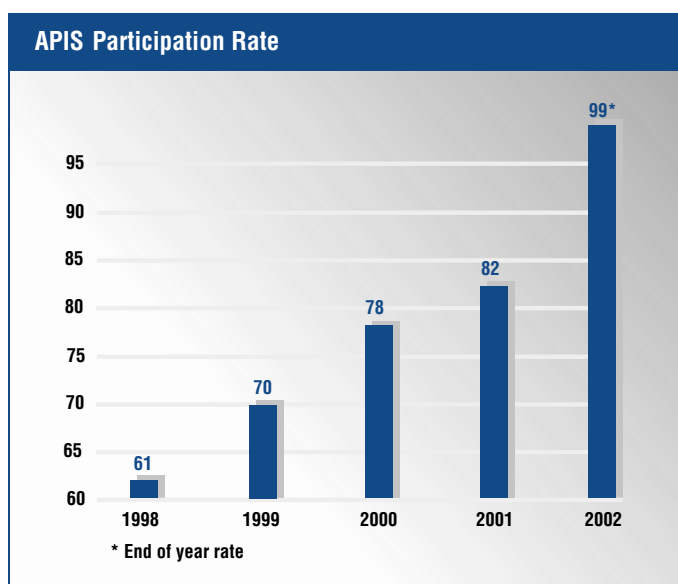


Customs inspector monitoring operations from a distance.

integration of rule scoring for Passenger Name Record data, APIS Passenger Sweep rule scoring for anti-terrorism, and additional Treasury Enforcement Communication System (TECS) functionality.

Target: An APIS rate target was not established for FY 2002. Due to legislation mandating 100 percent participation in APIS, Customs has determined that a more meaningful measurement for this program is the percentage of data received from the carriers that is useful for law enforcement purposes. (The former measure captured the percentage of carriers participating in APIS.)

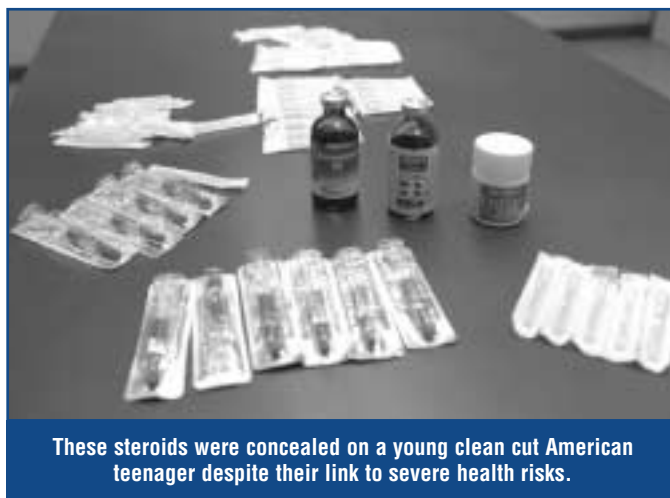
Results: 94 percent of the data received by Customs in FY 2002 passed basic systems edits. A target will be set for FY 2003.



Performance Goal 2: Deploy selectivity techniques, technology, and tools for the physical inspection of passenger baggage and vehicles to mitigate potentially high-risk and destructive situations (examine).

Performance Measure: Degree to which targeted examinations are superior to random examinations of passengers.

In recognition of current resource constraints and heightened security concerns in a post-September 11 environment, Customs is focusing on technological solutions to meet present and future border security needs. Deployment of these initiatives assists Customs in meeting both enforcement



and customer service strategic goals by allowing for the pre-screening of passengers, the identification of high-risk travelers, and the facilitation of compliant travelers.

A successful example of deployed technology for the land border environment is the License Plate Reader (LPR) program. As passenger vehicle counts have increased, Customs has made a commitment to develop and use technology to enhance processing capabilities. LPR units automatically locate, read, and communicate vehicle license plate data to TECS and the National Crime Information Center (NCIC) for possible record matches. The primary inspectors receive instantaneous responses. The license plate information is subsequently archived in TECS for possible use at a later date. As of September 2002, Customs has installed 256 inbound and 50 outbound LPRs on the Southern Border, and 50 inbound LPRs on the Northern Border.

Customs also continues to explore land border targeting technology. The Land Border Vehicle Targeting System (LBVTS) is a software-based analysis tool designed to “score” vehicles as high or low risk. The risk is based on several key functions, including crossing data, TECS and Division of Motor Vehicle records, the person to whom the vehicle is registered, the address of the registered vehicle, and other vehicles registered to that same address. By using the LBVTS tool, vehicle crossing patterns and associations can be seen and discrepancies to those patterns will be noted by a score.

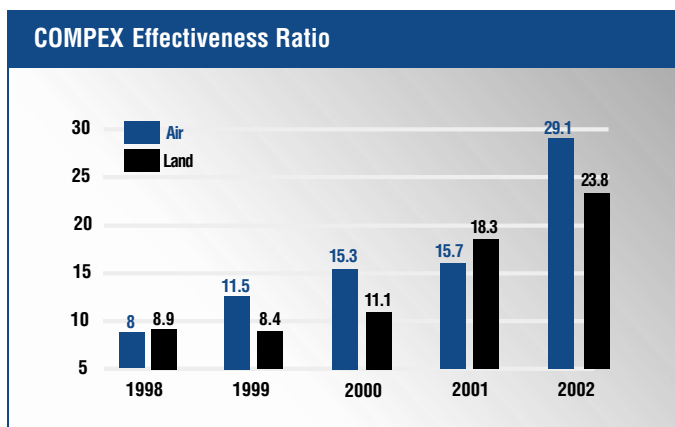
Customs continues to receive funding for testing and deploying Non-Intrusive Inspection (NII) technology to enhance and augment our enforcement programs. NII technology enables Customs to examine areas that are difficult

or impossible to examine with conventional means, such as inside tires, gas tanks, false walls, ceilings or floors. NII provides for a less invasive method of inspecting, as opposed to drilling or dismantling of conveyances or merchandise. NII technology is the critical key to maintaining overall effectiveness while facing a rapidly growing workload.

Customs is deploying multiple technologies to support its layered inspection processes. Some are imaging systems that produce “x-ray” images of a container or vehicle; others provide identification of specific materials. Any single sensor or device may be defeated by a determined adversary, so Customs does not rely on any single technology but uses multiple technologies in different combinations to minimize the likelihood that contraband would be undetected.

Customs continues to measure the effectiveness of its selection process by conducting the Compliance Measurement Examination (COMPEX) Program. COMPEX compares violations found during targeted enforcement exams with violations discovered during examinations of random samples of passengers. This comparison provides a measure of how well our selection programs are achieving the Customs objective of effective targeting.

Target: The Targeting Efficiency Rate should be better than the COMPEX random targeting rate by multiples of 10.0 for air and 11.0 for land during FY 2002.



Results: For FY 2002, the air Targeting Efficiency Rate was 29.1 times better than COMPEX random targeting. In the land environment for passenger vehicle processing, the Targeting Efficiency Rate was 23.8 times better than COMPEX random targeting.

Performance Goal 3: Intercept high-risk passengers while facilitating the processing of low-risk passengers (intercept and expedite).

Performance Measure: Efficiency of personal search results.

Customs made a strong effort to improve the effectiveness of our selection, interception, and examination performance by employing tools and technology designed to screen for potential violators while facilitating the clearance of compliant passengers. To maximize agency effectiveness, Customs has coordinated the deployment of technology with the institution of specialized training initiatives. Customs developed and administered targeting training for Passenger Analytical Unit (PAU) Inspectors; anti-terrorism PAU training will be launched in early FY 2003. Customs PAUs are located at major airports, and focus on the targeting, identification, and interdiction of high-risk passengers.

The Passenger Data Analysis Team (PDAT), located at Headquarters, has employed a full-time statistician to assist in the analysis of national, geographical, and port level enforcement examination data and results, which are disseminated to field managers for review.

Other technological tools which Customs has continued to develop include Dedicated Commuter Lanes (DCLs), which include the Secure Electronic Network for Traveler's Rapid Inspection (SENTRI) on the Southern Border and NEXUS (a border passenger screening system) on the Northern Border. The DCL programs allow Customs to facilitate low-risk travelers while allowing other resources to focus on the targeting of high-risk travelers and conveyances.

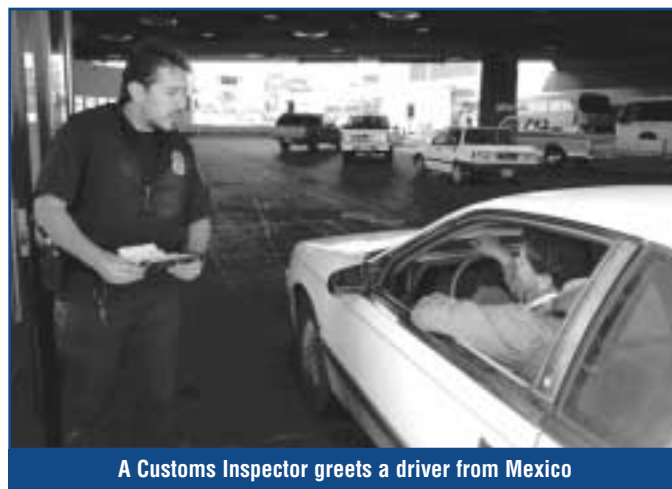
The NEXUS pilot program was tested at Port Huron, MI, and opened in Blaine, WA, on June 26, 2002. The NEXUS working group, a committee formed as a result of the Shared Border Accord and comprised of representatives from U.S. Customs, U.S. Immigration and Naturalization Service (INS), Canada Customs and Revenue Agency

(CCRA), and Citizenship and Immigration Canada (CIC), have been working on the program intensively since August 1999. The U.S. and Canadian Federal Inspection Services screen applicants for violations. Approved applicants are issued photo-identification and a proximity card. The principles of NEXUS allow only pre-screened, low risk travelers to be processed by Customs or INS via a dedicated lane with minimal or no delay at our land borders. Due to the success of the NEXUS pilot project at the Port Huron, MI, and Sarnia, Canada, border crossings, Customs, INS, CCRA and CIC are currently working to expand the NEXUS program across the U.S./Canada border.

The Customs Service and an INS Ad Hoc Committee assisted by the Justice Partnership for Reinvention developed SENTRI. The Customs Service, INS, the Border Patrol, the Department of Transportation, and the Department of Justice make up the SENTRI project team. SENTRI is currently operational at Otay Mesa, CA, San Ysidro, CA, and El Paso, TX. Installation of SENTRI at San Ysidro, Otay Mesa, and El Paso has significantly improved traffic flow by use of dedicated commuter lanes for low risk travelers. The average wait time for SENTRI participants is 1 minute. There are approximately 20,000 participants for all three locations. On June 11 and 12, 2002, Customs, INS, and Mexican Immigration met in Mexico City to discuss the expansion of SENTRI along the U.S./Mexico Border as part of the U.S./Mexico Border Partnership.



Canine inspection of passenger baggage.



A Customs Inspector greets a driver from Mexico

Target: FY 2002: Improve the ratio of positive personal searches by 30 percent. Achieve a positive personal search rate of 23.14 percent for air and 10.4 percent for land.

Results: While Customs did not meet the goal of 30 percent improvement, or the target positive search rates, Customs still increased the Personal Search Efficiency Rates (SER) in FY 2002 for both air and land passengers:

	FY 2001	FY 2002
AIR SER	18.1	20.7
LAND SER	8.8	9.1

The following figures show the trends in total cocaine, heroin, and ecstasy seizures associated with arriving air, land, and sea travelers. Please note that these are only one part of total overall Customs drug seizures, discussed under our Narcotics Trafficking Strategic Goal.

Type	FY 1999	FY 2000	FY 2001	FY2002
Cocaine	1,226	1,204	1,319	1,291
Heroin	517	577	626	696
Ecstasy	112	206	303	243

The decrease in seizures associated with arriving passengers for cocaine and ecstasy is probably related to the decrease in passengers arriving in FY 2002 after the events of September 11, 2001.

Performance Goal 4: Maximize passengers' voluntary compliance with federal laws and regulations by increasing their awareness of Customs requirements (informed compliance).

Performance Measure: Compliance rate for arriving air and land passengers.

By improving the knowledge of both the frequent and infrequent traveler, Customs believes the number of inadvertent violations can be significantly reduced. Communication methods, such as posting information on the Internet, loop radio broadcasts at land borders, videos providing airline information, and electronic information booths (kiosks), allow Customs inspectors to focus more fully on serious violators. Customs has established Passenger Service Representative (PSR) positions at key airports of entry to assist travelers with Customs problems and to manage local complaints. We have placed informational signage and supplied brochures at all inspectional facilities, including the distribution of uniform PSR posters to all locations with PSRs.

Customs has built upon the comment card program by developing and implementing a new automated version. The use of this new technology will allow for a more comprehensive analysis of traveler feedback and will facilitate the dissemination of the information to managers in field locations.

Customs continued to stress workforce training as a critical element in customer service by continuing to administer the 16-hour Inspection and Interaction Skills Workshop, mandatory professionalism training for all uniformed personnel.

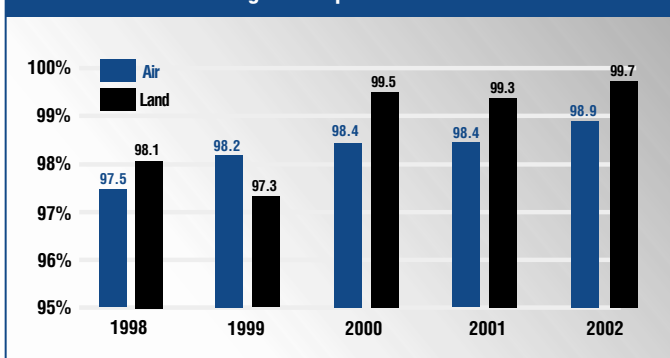
Target: Achieve a compliance rate of 99.0 percent for all arriving air and all arriving land passengers in FY 2002.



Examination of vehicles crossing our border is an important part of Customs work.

Results: The compliance rate for arriving air passengers in FY 2002 was 98.9 percent, or very slightly less than the target for the year. The deviation from the target goal is not significant and Customs considers this goal for the year met. The actual compliance rate for arriving land passengers was 99.7 percent, an increase over FY 2001. The target goal for land passengers was thus also met.

Air and Land Passenger Compliance Rates



CUSTOMS NEW OFFICE OF BORDER SECURITY

Historically, Customs has successfully targeted for narcotics and currency violations in both the passenger and trade environments. Immediately following the terrorist attacks on September 11, Customs adapted its targeting methodology for anti-terrorist and national security concerns. Recognizing the scope of the threat, Customs created an Office of Border Security (OBS) within the Office of Field Operations (OFO).

The OBS began around the clock operations on November 10, 2001. Harnessing the targeting skills of inspectors and field analysis specialists from the OFO, the OBS coordinates and centralizes the OFO responses to anti-terrorist and national security concerns. Under the guidance of a supervisory inspector (Watch Commander), inspectors and analysts convert raw intelligence into tactical targets. The OBS also provides field elements with additional research assets for passenger and cargo examinations.

The OBS provides Customs with critical linkage in several areas. The office is comprised of personnel that are well-versed in air, sea, and land border targeting, for passengers and cargo, in the inbound and outbound environments. Bringing field targeting disciplines together provides Customs centralized cross-targeting with nationwide coverage. The OBS also provides for OFO liaison with the Office of Investigations (OI) and the Intelligence Division, and subsequently, the law enforcement and intelligence communities. Centralized OBS targeting endeavors, combined with intra and interagency collaboration, assure Customs of a coordinated response to national security events.

For almost two decades, Customs has been actively engaged in three industry partnership programs. These programs are designed to deter and prevent narcotics from being smuggled into the United States via commercial cargo and conveyances; and seek to enlist the trade communities support in narcotics interdiction-related activities both domestically and abroad. These anti-drug initiatives include the Carrier Initiative Program (CIP), the Business Anti-Smuggling Coalition (BASC), and the Americas-Counter Smuggling Initiative (ACSI). By reviewing a participant's security procedures, Customs can help improve a participant's cargo and conveyance integrity by improving overall physical, procedural, and personnel security practices. Through these programs, Customs asks the private sector to share the responsibility of smuggling prevention through partnership with Customs.

Over the past seven fiscal years, our business partners have provided information to Customs which has resulted in the domestic seizure of over 95,000 pounds of illegal drugs; and have assisted foreign law enforcement in the seizure of over 215,000 pounds of illegal drugs. The drug interdiction effort is discussed more fully in our discussion of the Narcotics Trafficking Strategic Goal.



A small number of Customs employees patrol huge spaces.



A Customs Inspector uses a shopping cart to unload forty kilos of marijuana from a vehicle attempting to enter the U.S.

TRADE AND ECONOMIC GROWTH



Under Customs Container Security Initiative, Customs inspectors will be on site at foreign ports to deter potential acts of terrorism.

GOAL: To stimulate and protect the economic interest of the United States by maintaining a sound trade management system which maximizes compliance with import and export laws and moves legitimate cargo efficiently.

OVERVIEW

The motto “protectors of the border” still holds true today. Our agency is relied upon to process imported merchandise and protect our economy against all threats to our national security. In that regard, the men and women of Customs serve as our first line of defense. Our employees scrutinize passengers, shipments, and conveyances. At the same time, efforts are underway to develop an automated system that can handle the increased workload.

As an effort to involve the trade community in combating terrorism, C-TPAT was implemented. The purpose of this partnership is to improve security along the entire supply chain, ensuring the facilitation of compliant merchandise into the United States. C-TPAT is the principal government-trade partnership developed and implemented since September 11, 2001, to improve border security and facilitate trade. At fiscal year's end, there were over 650 companies participating as C-TPAT partners.

On the export side, Customs has the responsibility to ensure that cargo being exported from the United States is in compliance with federal laws and regulations. The objectives in the export area that support our strategic goal are to:

- increase automation of export documentation;
- increase compliance with manifesting and Shipper's Export Declaration (SED) regulations; and
- expedite processing of legitimate export cargo.

CHALLENGES

Workload Challenges

The events that occurred on September 11, 2001, reinforced the need to take a strong stance in protecting our borders. One challenge in attaining our goal to combat terrorism is the shortage of personnel. Approximately 150 Customs employees were called to active military duty after the September 11 attacks. Customs officers began to work long hours to guard our borders against terrorism during the higher level of security alert (Level 1). Customs deployed inspectional personnel to land ports along the Northern Border to enhance the Level 1 alert status.

As a result, normal audits of exporters were not conducted during the first two quarters of the fiscal year. In addition, Customs reassigned 380 inspectors to 19 international airports around the country to strengthen the security measures already in place. Some of Customs programs were reassessed, placed in maintenance mode, or modified as a result of Customs moving to a higher level of security alert. These changes pose a challenge to Customs trade personnel. One way to meet this challenge is to improve communication between Customs offices and other federal agencies in order to expand our trade enforcement and facilitation efforts in the effort to make our country safer.

Automation Challenges

Among the greatest challenges confronting Customs is that of achieving both safe and efficient trade. The ongoing security threat, combined with accelerating international trade, requires that Customs maximize the flow of legitimate goods while, at the same time, minimizing risks to national security.

By serving as the IT platform for C-TPAT and CSI, ACE will allow the U.S. Government to push out our borders and achieve worldwide visibility of the workings of the commercial supply chain.

Currently, Customs uses ACS to process the huge number of shipments that cross our borders each year. ACS has exceeded its life expectancy and simply will not meet long-term requirements driven by enforcement responsibilities, the growth in trade, and new legislative demands. Development of ACE, the system that will replace ACS, has begun. The Customs Modernization Office (CMO) of the Office of Information and Technology is leading this effort. ACE will support both Customs and the trade community by processing imports and exports more efficiently and by automating time-consuming and labor-intensive transactions. By creating a single Internet-accessed system, ACE will enable interactive communication and collaboration across Customs, border agencies, and the trade community. ACE will also provide importers with national views of their activities, thereby helping them to improve their compliance.

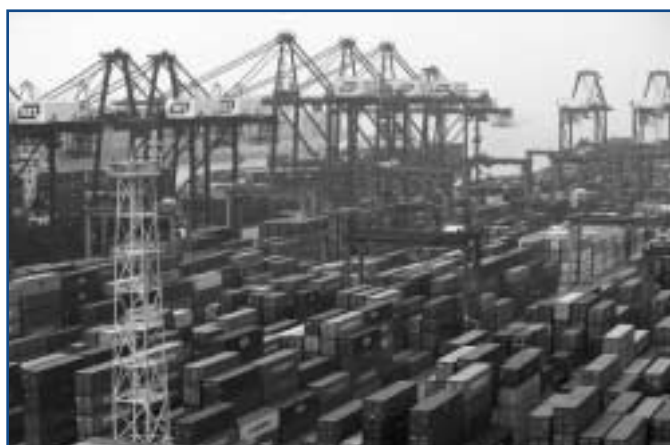
Implementation of ACE will create the following benefits for Customs and the trade community:

- paperless e-filing
- consolidated statements and periodic payment
- reduced data entry
- streamlined automated manifests
- national account management
- streamlined billing, collections, refunds, quota, and duty filings.

The information-sharing capabilities of ACE will also enhance enforcement efforts. The earlier technology and information is available in the supply chain, the better the opportunity Customs and other agencies have to successfully target and intercept suspect shipments prior to their reaching our borders.

Congress appropriated \$130 million for ACE for FY 2001 and \$300 million for FY 2002. These funds allowed Customs to select the systems integration contractor and start the design, development, and integration of the modernized trade system. In April 2001, Customs awarded the Modernization Systems Integration Contract to the e-Customs Partnership (eCP), led by IBM Global Services. The Trade Support Network, comprised of representatives of various trade groups and Customs, has provided input to Customs and eCP on the design of ACE. By the end of May 2003, it is anticipated that selected Customs employees and approximately 40 initial importer accounts will be able to start using ACE's first account management tools over the Internet.

With the expanded globalization of trade and commerce and the expansion of free enterprise and trade, Customs faces a serious challenge in investigating and preventing trade fraud violations. Technological advances associated with computers and the Internet provide increasing opportunities for criminal groups and organizations that exploit the international market place to further their illegal activities. Terrorist cell groups may seek to provide financing for their activities through Intellectual Property Rights (IPR) violations, tobacco smuggling, in-bond diversion, and forced labor. Customs has increased its efforts in these fields of investigation by developing the IPR Center, with joint participation from the Federal Bureau of Investigation (FBI); using the Tobacco Smuggling Task Force; and creating several positions assigned to foreign offices to investigate forced child labor violations.



Containers play a major role in U.S. trade and present opportunities for terrorist threats.

ANALYSIS OF PERFORMANCE

From 1998 through 2001, the overall trade compliance rate improved significantly, rising from 89 percent to 91 percent. With overall compliance at a relatively high level, Customs began to emphasize matters of significant trade risk. In FY 2002, the Office of Strategic Trade (OST) introduced new integrated methods to focus Customs actions and resources around trade risk. With a shift in focus to significant trade issues and initiatives, Customs has maintained its national, strategic perspective on trade while evolving to address new trade risks.

Overall Impact Statistics:

Projected FY 2002 Total Value of Imports: \$1,193 billion

Source: Department of the Treasury, Office of Tax Analysis

FY 2002 Total Entry Summary Count: 24.9 million

Source: U.S. Customs Service (USCS) ACS data retrieved via dataquery

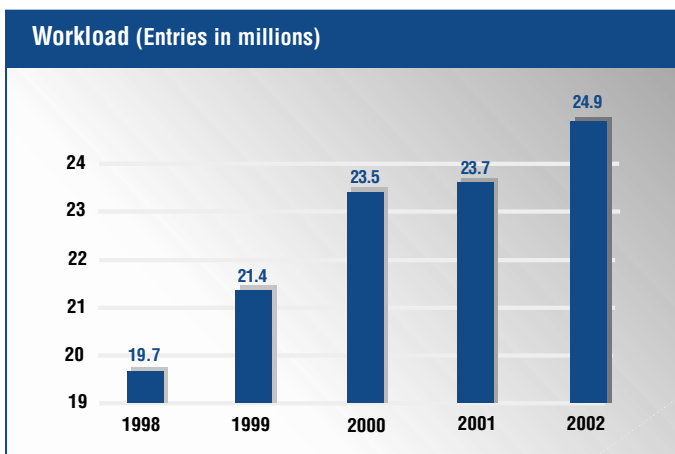
1st 6 months *FY02 IPR Seizures (number): 2,781

Source: USCS, OST, Los Angeles Strategic Trade Center

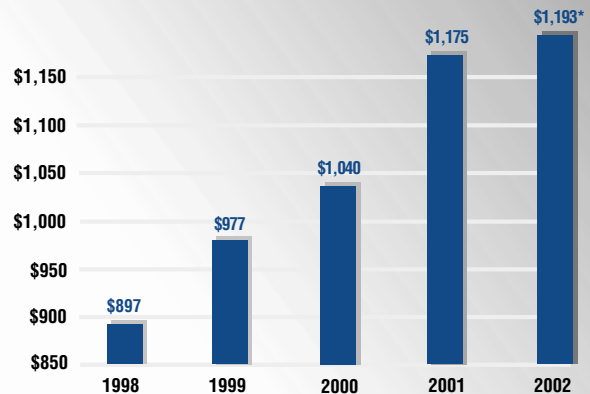
1st 6 months *FY02 IPR Seizures (value): \$26.6 million

Source: USCS, OST, Los Angeles Strategic Trade Center

**Note:* It is impossible to make reasonable estimates for IPR seizures for the second half of FY 2002, therefore the figures that have been provided above are actual figures for the first half of the year rather than projections.



Value of Imports (in billions)



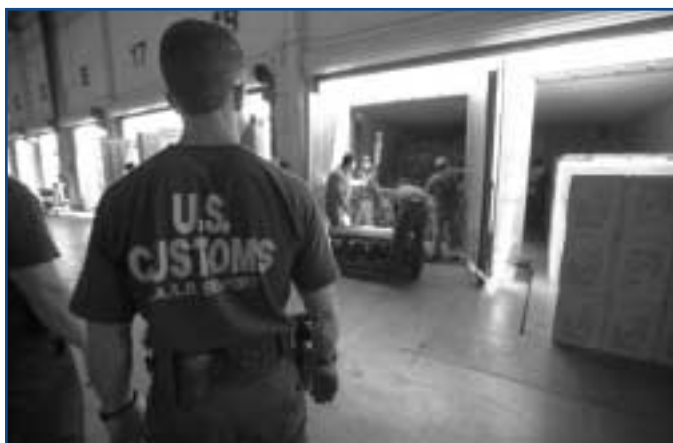
* Office of Tax Analysis, Department of Treasury
Source of prior year data was the Department of Commerce

Compliance Measurement

In FY 1995, Customs initiated the Compliance Measurement (CM) program to collect objective statistical data to determine compliance with U.S. trade laws, regulations, agreements, and estimate the revenue gap. Compliance data was used in risk management decisions to identify high-risk areas and measure the effectiveness of actions taken to improve compliance in those areas.

The CM was temporarily discontinued following the September 2001 terrorist attacks on the United States. Resources ordinarily used for compliance measurement activity were redirected to border security activities. An overall compliance rate for FY 2002 is not available because of the limited compliance sampling during that time.

In late FY 2002, Customs resumed compliance measurement after the program was modified to better support our national security initiatives. The scope of compliance measurement was expanded to include information on the transportation process that brought the product to the United States. Since the global transportation system could be used as a conduit for terrorists and their weapons, compliance measurement now looks for evidence that the security of the supply chain has been compromised.



Customs staff at work at Los Angeles/Long Beach Seaport.

Compliance measurement continues to play an important role as a quality control on the accuracy of trade data. Unreliable trade data increases the risk that critical threats will not be identified. It also undermines our capability to locate specific targets based on tactical intelligence. In this way, compliance measurement plays an important role in our layered approach to border security.

Partnership with the International Trade Community

Customs engages the entire breadth of the international trade and transportation communities in productive partnerships that provide a forum to exchange ideas and share experience. This engagement allows the private sector to provide input into legal, operational and policy concerns and Customs to incorporate feedback from the private sector into key initiatives. Customs-industry partnerships have produced vital programs that enhance national security while facilitating legitimate commerce.

The Office of Trade Relations functions as liaison between Customs officials and the international trade community and is responsible for fostering a positive relationship with the trade community. This office is the primary contact for trade representatives to advance issues and ideas to Customs, and for Customs to advance its agenda to the trade community. Customs mission of homeland security cannot be accomplished without the assistance and active participation of the trade community, and this help is crucial if we are to safeguard the American homeland as well as contribute to the continued growth of the world economy.

Customs-Trade Partnership Against Terrorism

As part of a comprehensive plan to confront the terrorist threat to the United States, the Customs Service has established C-TPAT. C-TPAT is a joint, government-business initiative to develop and sustain a secure supply chain while maintaining a high level of trade compliance that provides reliable cargo release targeting data. C-TPAT is designed to enable Customs to ensure safe and secure borders against terrorism while providing an import process marked by the efficient release of cargo and the prompt resolution of issues affecting C-TPAT participants. C-TPAT uses and enhances the security processes currently employed by the trade community to assure that international shipments are not compromised or diverted by terrorists or their accomplices. In that regard, a C-TPAT participant is expected to conduct a verifiable self-assessment of its current supply chain security procedures and enhance security where vulnerabilities are identified. C-TPAT participants also make a commitment to work with their service providers throughout their supply chain to enhance security processes and procedures worldwide.

Beginning with an April 16, 2002, opening ceremony with seven charter members at the Ambassador Bridge in Detroit, Customs began accepting C-TPAT applications from all U.S. importers and has since expanded the program to include carriers, brokers, and freight consolidators.

By the end of Fiscal Year 2002, more than 513 importers, 48 carriers, 60 brokers, and 38 freight consolidators had joined C-TPAT with Customs planning an open enrollment for port authorities, exporters, and other foreign companies in Fiscal Year 2003.

Through its cooperative approach between the trade community and Customs, C-TPAT creates an environment in which a secure supply chain results in the facilitated movement of goods and services across borders. In addition to this inherent benefit, C-TPAT participants will be eligible for other potential benefits, including a reduced number of cargo examinations and eligibility for account-based programs designed to streamline Customs processes.

It is envisioned that C-TPAT will constitute an ongoing dialogue between the trade community and Customs. As the nature of potential threats changes and the security requirements of the trade community are correspondingly adjusted, Customs will engage its partners to make the requisite program adjustments to ensure the safety of the international supply chain.

Account Management

Customs goal is to utilize account-based methods consistent with risk management principles to develop and maintain the highest levels of trade compliance which incorporate supply chain integrity with border security to enforce, regulate, and administer U.S. trade laws, while fostering the flow of lawful international trade.

The data from the import CM is the foundation for many of the risk-based programs used by Customs to target trade violations and assist in the facilitation of trade. The Account Management Program monitors the Customs-related operations and trade compliance of the nation's largest importers. The top 3,000 importers account for 72 percent of all U.S. imports and it is clear that their performance has a substantial impact on the overall trade compliance. Data compiled from the CM shows that, from FY 1998 to FY 2001, managed accounts had an average compliance rate 3.25 percent higher than that of all other importers. While the CM program was limited during FY 2002, account managers continued to work with their accounts to improve their overall compliance.

Ensuring the compliance of the largest U.S. importers gives Customs the ability to focus on managing an expanding workload. The Customs Account Management Program now includes over 1,100 companies; a cadre of National Account Managers manages 275 companies. The remaining 833 are managed locally by account managers at various ports of entry nationwide. The total number of accounts is increasing as a result of importer enrollment in C-TPAT. This increase in accounts demonstrates Customs commitment to move from a transaction-based processing methodology to a more customer focused account-based approach for increasing compliance and enhancing border security.

With the creation of C-TPAT, the roles and responsibilities of the Account Management Program expanded significantly in FY 2002. Customs account managers became the primary discipline promoting participation in C-TPAT and discussing supply chain security with trade participants with managed accounts. Through these efforts, many firms with managed accounts were among the first to join C-TPAT. The Account Management Program will continue with its efforts to ensure secure supply chains by working with new and existing accounts to improve the security programs of the firms involved. Account managers will also continue to monitor import data to ensure that firms with accounts remain in compliance with all importing laws and regulations.



Customs examines arriving air cargo.

ORR Expedites Processing of Customs Rulings Requests

The ability of importers to receive timely binding customs rulings on specific import transactions was the cornerstone of Customs obligations under the Modernization Act concept of informed compliance. However, prior to Fiscal Year 2002, due to competing priorities over the years, the Office of Regulations and Rulings (ORR) Headquarters had not met the timeliness aspect of that obligation. The ORR New York Office, which had always fulfilled its timeliness obligations (issuing rulings in 30-days or less), suffered a devastating setback when the World Trade Center was destroyed by the terrorists on September 11, 2001. Along with this destruction went an untold number of research and reference files along with samples of imported goods relating to pending ruling requests.

Pursuant to instructions from the Commissioner of Customs in January of 2002, ORR Headquarters identified all ruling requests pending for more than 90 days and devoted its primary resources to eliminating this backlog. At that time a total of 757 administrative ruling requests over 90 days in process were pending in ORR. As a result of making this a priority task, by September 30, 2002, ORR had completely eliminated its backlog of rulings, meeting the Commissioner's mandate in less than 8 months. Since that time, ORR Headquarters has maintained a 90-day turnaround time on all administrative rulings. In addition, the ORR New York 30-Day Ruling Program was restored to pre-9/11 operation level by December 3, 2001. This feat was accomplished less than 3 months after the destruction of the World Trade Center. Since the program has been reinstated, the National Commodity Specialist Division has issued over 8000 rulings. The average processing time for these rulings has been approximately 20 days, ten days less than the promised 30-day turn-around time.

Regulatory Audit

Regulatory Audit assesses importer compliance with Customs laws and regulations, as well as the compliance of the North American Free Trade Agreement (NAFTA) and drawback claimants, brokers, foreign trade zones, bonded warehouses, and a variety of special trade program areas. In the last 7 years, Regulatory Audit has completed 500 audits of major importers, covering almost 30 percent of the total entered value of imports.

The core business of Regulatory Audit is the Focused Assessment, a major importer audit that has replaced the Compliance Assessment. By assessing the risk of the various Customs programs in a company, and evaluating a company's internal controls, the Focused Assessment reduces its scope

of auditing to only those areas that present a risk to Customs. In this way, Regulatory Audit resources are carefully applied to achieve the maximum coverage in the trade area while reducing the intrusiveness to importing companies.

In addition to Focused Assessments, Regulatory Audit initiated a new form of partnership with the trade community in FY 2002, the Importer Self-Assessment Program. This program, opened to applicants in June 2002, builds on the strides in compliance taken by many large importers, as well as the knowledge Customs has acquired about these companies' compliance efforts over the years.

ISA provides the opportunity for importers who have demonstrated a commitment to compliance to assume responsibility for monitoring their own compliance, in exchange for real benefits, which include: less Customs oversight; support and assistance from Customs when requested; exclusion from compliance audits; expanded opportunities for prior disclosure; and better business certainty and tailored benefits based on industry needs.

Focused Assessments

Customs conducts audits of major companies to assess their compliance with a variety of laws and regulations governing imports into the United States. In FY 2002, Customs replaced the compliance assessment process with Focused Assessments. Customs made this transition based on the knowledge gained from over 7 years of conducting 500 Compliance Assessments and working closely with the trade.

Focused Assessments are conducted according to professional auditing standards. They are led by regulatory auditors and include other trade experts within Customs such as import specialists, international trade specialists, and account managers that are part of the team. Focused Assessments can be completed in a lesser time frame than Compliance Assessments depending upon the accessibility of records and the level and strength of company internal controls.

Focused Assessments utilize principles of risk management to concentrate on those areas of a company's import procedures that present the greatest risk of non-compliance. Customs designed this methodology after studies showed that clear and strong internal controls are the best predictors of compliance. Through this new streamlined methodology, Customs audit reviews will be less intrusive for compliant companies that have made the investment to institutionalize effective internal business controls over their import procedures.

Importer Self-Assessment

Customs is committed to encouraging companies to share the responsibility for compliance with trade laws and regulations. The ISA program is a voluntary approach to trade compliance - it provides a path for recognition and support for importers who have demonstrated a long-term commitment to compliance. For those companies who are ready to assume the responsibilities for self-assessment, ISA offers meaningful benefits that can be tailored to industry needs. ISA is designed to complement and support C-TPAT. The two programs are related in that they are based on the principles of partnership and self-governing. In addition, both programs offer significant benefits to participants. However, while ISA focuses on trade compliance, the emphasis of C-TPAT is on the security of the supply chain, which is critical in the war against terrorism. Therefore, C-TPAT membership comes before ISA, and in order to be eligible for ISA, companies must join C-TPAT.

The ISA program is primarily based on the development and use of established business practices and good internal controls designed specifically for a company's Customs operations. The importer may structure internal controls and procedures to meet individual needs.

Trade Enforcement

While our emphasis has shifted to homeland security defense during FY 2002, Customs continues to employ a variety of investigative and operational programs to deter predatory and unfair trade practices. Using a variety of investigative programs, linked to stopping predatory and unfair trade practices, Customs investigators and officers have partnered to disrupt and dismantle entities employing illegal trade practices that negatively impact U.S. trade policies and laws. A sampling of program activities from FY 2002 described below shows the scope of Customs efforts to protect IPR, eradicate forced child and prison labor, and investigate textile and North American Free Trade Agreement (NAFTA) violators.

Steel 201

During FY 2002, the model for the trade risk focus has been the administration of the Presidential Proclamation (Sec. 201) on steel imports. This action affected over \$1.6 billion in steel imports, more than 105,000 entry lines, and projected duties in excess of \$60 million. A Steel 201 Strategy was developed to provide an integrated action plan and included elements of targeting, verification, analysis, and enforcement. This swift and effective strategy led to a steady decline in non-compliance, with the number of discrepant lines dropping by as much as 39 percent within the first two months from the Steel 201 Strategy effective date.

Intellectual Property Rights

Customs has continued its historic partnership with the creative community to protect IPR through its recordation process, which provides an economical approach to border enforcement for copyright and trademark owners. The global economy has become more service-and idea-based, and use of the Internet continues to grow. At the same time, new technologies have been developed that decrease the cost of illegally duplicating and distributing items subject to IPR protection. The Customs Cyber Smuggling Center (C3) is dedicated to the investigation of international criminal activity, including IPR violations, conducted on, or facilitated by, the Internet.

Customs and the FBI have also established the National IPR Coordination Center (IPR Center), located at Customs Headquarters. The IPR Center is a multi-disciplinary entity employing a coordinated approach against IPR violations on the domestic and international fronts. The IPR Center has



Customs protects intellectual property rights by preventing importation of cheap "knockoffs" of legitimate products.

coordinated a number of significant ongoing IPR criminal investigations. The IPR Center can provide assistance in a variety of ways: general IPR information, trademark and copyright research, trade contacts, seizure statistics, and port training.

During the first half of FY 2002, several IPR initiatives were conducted that resulted in 2,781 seizures with a domestic value of nearly \$27 million. One such initiative was the creation of the IPR Industry Officer Program to help address trade risk posed by IPR. Certain industries were selected based on risk for IPR infringement with priority given to industries with the highest external stakeholder interest. IPR industry officers organized training for Customs officers taught by 40 rights holders in five high-risk ports to better enable Customs staff to recognize counterfeited goods.

Among its other enforcement activities, the IPR Center is currently coordinating a transnational IPR investigation involving counterfeit software. This coordination involves the direct oversight and analysis of intelligence and information from investigations being pursued by Customs and the FBI. In September 2002, the Center hosted an international strategy meeting associated with this investigation. Participants include Customs/FBI domestic offices, attaché offices, and trademark holder investigators.

Forced Labor

Title 19 United States Code, Section 1307, is the basis for prohibiting the importation of merchandise manufactured or produced with the use of forced, convict, or indentured labor. Customs, in enforcing this statute, seizes the merchandise, re-exports it, and recommends criminal prosecution for willful violators. This measure also includes products manufactured using forced or indentured child labor.

The Customs Forced Labor Command Center develops leads, researches allegations, provides support and guidance, and coordinates investigative activities by Customs investigative offices, both foreign and domestic. Investigations have included the use of forced child labor in the harvest of cotton in Uzbekistan and cocoa beans in the Ivory Coast, as well as the use of prison labor in China to produce a multitude of products. Currently, Customs has numerous active detention orders against manufacturers in China, Mexico, India, and Japan. These orders prohibit the importation of products from these manufacturers into the United States, due to the use of forced labor.

In FY 2002, 16 forced child labor cases were opened. In addition, resources were provided domestically and abroad to address forced child labor issues; the Forced Child Labor pilot training course was completed and the inaugural class was presented; meetings were held between the Chocolate Manufacturers' Association (CMA) and Customs, in which CMA officials briefed Customs on initiatives to address the use of forced child labor in the cocoa bean harvest in the Ivory Coast; and Forced Child Labor Command Center agents conducted a survey team trip to Uzbekistan to determine the validity of allegations of the use of forced child labor in the cotton harvest.

Textile Enforcement

The illegal transshipment of textiles and wearing apparel was a major trade focus for Customs in FY 2002. To combat this threat, Customs completed Textile Production Verification Team (TPVT) visits to South Africa, Kenya, Lesotho, Mauritius, Macau, Taiwan, El Salvador, Guatemala, Nicaragua, Vietnam, and Cambodia. In addition, Customs performed joint observation visits in Hong Kong. Those visits resulted in a review of 335 factories. Of these, 46 were permanently closed, 43 were deemed high risk for transshipment, 38 refused admission, and at 5 factories evidence was found of transshipment. Of the 38 factories referred for investigation, 50 percent of the investigations resulted in the suspension/cancellation of export licenses. The review found 135 factories to be low risk. Targeting for the seven Textile Production Verification Teams was found to be very effective.

From October 1, 2001, to July 15, 2002, Customs seized \$16.9 million worth of textiles and wearing apparel that was either transshipped illegally or violated IPR. This represents

a substantial increase from the \$16.5 million Customs seized in the previous full year.

Customs goal for 2002 was to expand the partnership with its counterparts in Hong Kong. In January 2002, Customs targeted 33 factories and referred them to Hong Kong Customs and Excise for enforcement visits. In April 2002, Hong Kong authorities completed these reviews. Of the 33 factories targeted by Customs, Hong Kong authorities have taken enforcement actions against 27 of the factories (81.8 percent).

From May 2001 to May 2002, Customs identified violations at 162 factories that were subsequently closed. Merchandise valued at approximately \$300 million was stopped from entering the country. Since March 2002, Customs has excluded, seized, or caused the importer to re-export approximately \$1.78 million worth of illegally transshipped goods claiming Russian origin.

North American Free Trade Agreement

Performance Goals: One objective of the North American Free Trade Agreement (NAFTA) is the elimination of trade barriers to the legitimate movement of goods and services among the territories of the signatories—the United States, Canada, and Mexico. Customs performance goals related to the NAFTA include a 95 percent compliance rate for NAFTA transactions and the collection of at least 99 percent of duties, fees, and taxes.

Following the events of September 11, 2001, Customs went into a state of high alert. As part of the alert, many import specialists were temporarily assigned to activities supporting our increased security measures. The number of assigned NAFTA verifications in the FY 2002 Trade Agreement Sub Plan were reduced at ports where the number of import specialists decreased as a result of these temporary assignments.

Until the rollout of the ACE, alternate methods have been implemented for monitoring revenue recoveries related to NAFTA compliance activities undertaken by Customs field offices, as well as monitoring enforcement actions and penalty amounts collected.

The three NAFTA parties conduct \$1.7 billion dollars in trilateral trade every day. From 1993 (the year preceding the implementation of NAFTA) to 2001, trade among the NAFTA parties increased by 109 percent, from \$297 billion to

\$622 billion. U.S. exports to our NAFTA partners nearly doubled during that period from \$142 billion to \$265 billion, significantly higher than the 44 percent growth in exports to the rest of the world. NAFTA importations into the United States have grown from \$117.8 billion dollars in FY 1995, to approximately \$269 billion dollars for FY 2002.

Performance Measures Used to Evaluate NAFTA

Performance goals were distributed to Customs Management Centers and ports which set forth compliance and enforcement goals under the NAFTA program. Verifications are performed (1) of commercial importations claiming NAFTA (compliance measurement); (2) in order to target high-risk importers (port-initiated verifications); and (3) on post-importation refund claims. A total of 23 NAFTA exporter audits and one industry intervention were also conducted.

Results

- Total revenue recovery for FY 2002 was \$7.3 million, a significant increase over FY 2001.
- Denial of post-importation refund claims “protected” an additional \$.8 million in duties.
- The compliance rate for all compliance measurement NAFTA verifications conducted in FY 2002 was 90 percent.
- Port-initiated verifications, which are based on risk analysis, resulted in denial of NAFTA claims 31 percent of the time, which indicates very efficient field targeting.

One important investigation concerned a conspiracy between two companies to circumvent NAFTA by entering steel using false country of origin claims and undervaluing the entries to Customs. Initiated in FY 2002, this ongoing investigation has resulted in 16 seizures to date.

Tobacco Smuggling

The international smuggling of tobacco results in the annual loss of billions of dollars in tax revenue and customs duties around the world. Country of origin issues and reports of counterfeit cigarettes have been increasing steadily. Moreover, cigarette smuggling in Canada, Mexico, and Europe has attracted transnational organized crime groups, and some international terrorist groups have been linked to organized cigarette smuggling as a means of raising funds. Working with European counterparts, Customs has identified persons operating from the United States who are linked to several organized crime groups.

In FY 2002, Customs seized 1,047,575 cartons of cigarettes valued at \$27 million (representing lost federal tax revenue of approximately \$4.5 million), initiated 45 criminal investigations, and arrested 7 persons for cigarette smuggling and related offenses.

The Role of Non-Intrusive Inspection Technology in Preventing Trade Fraud

Non-Intrusive Inspection (NII) technology enables Customs to perform thorough examinations of cargo and conveyances without having to resort to the costly, time consuming process of unloading cargo for manual searches, or intrusive examinations of conveyances by methods such as drilling or dismantling. It also augments our staff in an attempt to maintain our enforcement posture while efficiently processing legitimate passengers and cargo.

Vessel and Air Manifest Export Compliance

Customs also measures compliance with trade laws in the vessel and air export environment. Customs assesses performance in four key areas: timeliness rate of filing manifest, timeliness rate of filing bills, matching rate of all bills, and compliance rate of the manifest. Each area mandates a certain level of scrutiny in vital locations. Customs has developed a snapshot compliance measurement for each category as indicated below.

Performance Goal: Customs strives to achieve an overall export compliance rate of 92 percent. The overall compliance figure (represented as the Compliance rate of the manifest below) is derived from compliance with several other key exporting requirements (shown below).

Results:

The FY 2002 compliance results for three key exporting requirements and the overall compliance rate are shown here:

	Vessel	Air
Timeliness of filing the manifest	81.7%	88.1%
Timeliness rate of filing bills	86.9%	84.8%
Matching rate of all bills	86.1%	78.2%
Compliance rate of the manifest	82.8%	80.6%

Because of September 11, 2001, the audits which provide information on export compliance were not conducted for the first two quarters of FY 2002. In the third quarter of FY 2002, Customs began conducting the audits again. There

were a total of 494 audits conducted for both outbound vessels and air carriers. The audits detected 2,952 violations that resulted in 124 penalties and liquidated damages for another 200 violations.

The overall level of compliance for vessels dropped to 82.8 percent for the two measured quarters. The decreased compliance was the result of a change in focus by Customs, from an overall industry focus to a focus on carriers with a higher risk of violations.

The overall level of compliance for air carriers for the two measured quarters dropped to 80.6 percent. Similar to the decrease in the compliance level for vessels, the focus of the audit program changed to a focus on carriers with a higher risk of violations.

Automated Export System

Customs has the responsibility to ensure that cargo being exported from the United States is done so in compliance with federal laws and regulations. One of the major tools in accomplishing this task is the Automated Export System (AES). AES has faced a number of challenges this year. AES is adapting to legislative changes mandating the filing of SED information via AES for commodities found on either the Commerce Control List or the United States Munitions List. Regulations are being written to require mandatory AES input for articles on these lists. Customs continues to update and improve edits within AES. These edits enable Customs to better enforce existing export regulations.

AES was developed as an automated reporting system for collecting export trade data from exporter and freight forwarders. AES collects data electronically from SEDs and manifests, accounting for 85 percent of all non-Canadian exports, with an error rate of 6 percent. In FY 2002, there were 7,007 filers submitting 19.1 million export transactions through AES. At the same time, Customs continues to handle approximately 190,000 paper SEDs per month.

Performance Results	Goals	Measured Results
Number of filers:	6,000	7,007
Number of SED transactions:	18.4 million	19.1 million
Percentage of transactions filed electronically:	85	85.5

Customs has realized the benefits possible from AES. Electronic reporting accounts for more than 85 percent of all export transactions. Customs has created enforcement modules, including State Department decrementation, Bureau of Industry and Security licensing, vehicle exports, and the vessel transportation module.

Customs continues to work on the AES Vessel Transportation Module. There are now six carriers participating in the program. Electronic filing of vessel transportation data in AES relieves both the trade and government of handling paper manifests and allows Customs to target high risk shipments on booking information submitted up to 72 hours prior to departure.

The Trade Act of 2002 requires electronic vessel manifest and SED data within 24 hours of the carrier receiving the cargo but not less than 24 hours prior to the vessel's departure. Additional legislation is pending in Congress that would extend the advance manifest and SED data requirements to all modes of transportation.

Effective May 1, 2002, Customs conducted a nationwide enforcement operation for all modes of transportation on the AES exemption statement because of concerns that the External Transaction Number (XTN) or Internal Transaction Number (ITN) reported as the exemption to filing an SED was not found in AES.

As of August 15, 2002, over 14,000 AES exemption statements have been verified by querying the XTN or ITN in AES. The failure rate (defined as the instance when a record cannot be found in AES at the time of export) remains stable at approximately 25 percent.

INVALID AES EXEMPTION STATEMENTS

TYPE	FREQUENCY
No Files/Late Files	15%
Incorrect Format or Illegible	5%
No Exemption Noted	1%
Reused ITN	1%
ITN Not Valid	1%
Other	2%

Due to improved edits, and legislative mandates, AES is becoming an effective tool for enforcement of U.S. export laws.

NARCOTICS TRAFFICKING



Concealed contraband is often difficult to detect.

Goal: Dramatically reduce the amount of illegal drugs entering the United States.

This goal ties directly to the Commissioner's priority investigative goal of increasing Customs effectiveness in investigating and enforcing federal criminal laws relating to drug trafficking.

OVERVIEW

The objective of the Customs Narcotics Trafficking Program is to disrupt and dismantle Drug Smuggling Organizations (DSOs) through the implementation of a unified intelligence, interdiction, and investigative effort, resulting in a significant reduction in the flow of drugs entering the United States. Although counterterrorism has

become the number one priority of the agency since the tragic events of September 11, 2001, Customs still remains a leader in interdicting and investigating drug smuggling activities and organizations. Our heightened state of security along America's borders has, in fact, strengthened, not weakened, our counterdrug effectiveness through the deployment of additional manpower and NII technology assets. In addition to NII technology, programs such as the Canine Enforcement Program increase our enforcement stature while effectively and efficiently processing trade and the traveling public. In addition, air and marine interdiction efforts continue to result in the interdiction of drug smugglers in the Bahamas and Northern Mexico, where smuggling activity remains strong.

Customs has been involved in efforts to disrupt and dismantle large and significant narcotics organizations not only through its own investigations, but also through its active participation in programs such as the Organized Crime Drug Enforcement Task Force (OCDETF), High Intensity Drug Trafficking Area (HIDTA) enforcement teams, and the Special Operations Division of the U.S. Department of Justice. Customs participates as the lead or partner in other joint interagency task forces designed to cripple the illegal drug trade such as the Joint Interagency Task Force, which coordinates the use of Coast Guard, Department of Defense (DOD), and Customs assets to pursue drug smuggling in the Transit Zone. Customs also leads the Border Coordination Initiative, a program to streamline the services provided by federal border agencies along our Southwest Border, the primary staging area for drugs.



Ships provide many inventive opportunities to hide drugs.

CHALLENGES

Customs faces numerous challenges in its mission to combat drug traffickers and significantly reduce the amount of illegal drugs introduced into the United States each year. DSOs seek to develop new and sophisticated methods to smuggle drugs into the United States by land, air, and sea. These organizations have historically proven to be fiercely determined and creative in order to reach their smuggling goals. They expend enormous amounts of money and time to thwart U.S. law enforcement efforts by finding new concealment techniques, organizing internal conspiracies, using various transshipment routes, and even attempting to corrupt law enforcement officers.

The demand for illegal narcotics remains high in the United States, and the methods that DSOs use to introduce contraband into our country is ever changing. Customs works to reduce the effectiveness of the strategies they employ through the use of coordinated intelligence, interdiction, and investigative efforts. The identification and dismantling of DSOs is essential to successfully combat drug smuggling.

As our nation's first line of defense, Customs plays a unique role in maintaining the integrity of our national security. Customs is challenged more than ever to secure our borders against the introduction of contraband, including narcotics and weapons of mass destruction, while expediting the movement of legitimate cargo and passengers. The greatest threat comes from the volume of trucks, containers, and rail cars that enter the United States each year. During FY 2002, 11.2 million trucks, 118 million vehicles, and almost 415 million passengers and pedestrians entered the country. The demands placed upon Customs workforce to screen and examine all targeted high-risk shipments have never been more challenging.

ANALYSIS OF PERFORMANCE

In FY 2002, Customs domestic and foreign special agents worked about 3.1 million hours on 22,008 narcotics smuggling investigations cases, which led to 12,570 arrests. Customs has continued its focus on conducting long-term, complex, and multi-faceted investigations in an effort to combat larger, more-sophisticated DSOs that have proven to be capable of utilizing available technology and employing creative methods to smuggle illegal drugs into the United States. Since these long-term investigations deal primarily



The popularity of Ecstasy presents a challenge for Customs drug interdiction efforts.

with large-scale DSOs, Customs has been successful in arresting more significant members of the targeted organizations.

While counterterrorism has become the number one priority of Customs, the fight against drug smuggling is still of paramount importance. In FY 2002, the total weight and quantity of heroin seizures increased, as did the weight per seizure. However, the total amount of cocaine and marijuana seized, as well as the number of their seizures, and pounds per seizure, declined. Customs continues to monitor and respond to the continuous shift in drug smuggling routes and methodologies.

Major FY 2002 highlights of Customs smuggling investigations include, but are not limited to: (1) Operation Panama Express, a Tampa-based OCDETF investigation, involves some of the most significant cocaine trafficking organizations operating in Colombia – organizations that are currently transporting in excess of 500 metric tons of cocaine annually to the United States via Mexico. In May 2002, a seizure made in the Eastern Pacific (EastPac) Ocean from the Colombian fishing vessel Paulo totaled 22,324 pounds, which is considered one of the largest cocaine seizures in history. Operation Panama Express has been recognized as one of the most successful joint operations ever conducted by law enforcement. (2) Operation Tronquista, a New York/Newark/JFK airport investigation, revealed that a Colombian narcotic smuggling organization recruited recent graduates from a New Jersey high school as heroin swallows and transporters of heroin-saturated clothing to smuggle heroin into the United States; 60 individuals have been arrested and approximately 220 pounds of heroin have been seized under Operation Tronquista since its inception

in May 2001. (3) Operation Riverwalk, a joint Customs/Florida Department of Law Enforcement HIDTA initiative to expand interdiction and investigative efforts along the Miami River, operated a 6-month surge interdiction effort together with an ongoing 2-year investigative and intelligence effort focusing on criminal organizations; agents have arrested 109 individuals and seized approximately 2,460 pounds of cocaine, 18 vessels, and \$31,000 in currency and monetary instruments since the inception of the operation in February 2001. (4) As of September 2002, 28 members of an international narcotic smuggling organization have pled guilty in the 5-year Puerto Rico/OCDETF case, Operation Night Eyes; investigation showed that the organization was smuggling narcotics from the Dominican Republic to Puerto Rico via fishing vessels and was distributing over 220 pounds of cocaine per month to at least a dozen cities in Puerto Rico and elsewhere in the United States.

In FY 2002, Integrated Border Enforcement Teams (IBETs) continued to become operational along the shared border of the United States and Canada. IBETs are comprised of Customs Special Agents working alongside agents and officers from several other U.S. and Canadian law enforcement agencies in an international effort to combat terrorism and other types of criminal activity along the border. As of September 2002, nine IBETs were operational along the shared U.S./Canadian border, operating as intelligence-driven teams to deter criminal organizations that have historically utilized the expanse of the Northern Border to smuggle people, merchandise, and contraband into the United States and Canada.

The Customs Intelligence Program deployed its first Foreign Intelligence Collection Team to Mexico. The team's purpose is to proactively collect drug intelligence in support of the Customs mission through development of various sources of information and informants. This is a partnership venture between Customs and the Drug Enforcement Administration.

With Source Zone operations suspended throughout FY 2002, the Air and Marine Interdiction Program provided detection and monitoring flights in the Caribbean and EastPac utilizing the operating bases at Aruba, Costa Rica, and Martinique. Those flights resulted in a number of significant seizures. The Air Program also continued to



Customs maintains the largest fleet of aircraft outside the U.S. Armed Forces.

support Operation Halcon, using Customs Citations to track suspect targets in Northern Mexico and vector Mexican ground forces to suspected drug offload sites. A total of 958 attempted smuggling flights landed in Mexico – short of the U.S. border – due to the cooperative efforts of the Customs Air Program and Mexican authorities. In FY 2002, Mexican authorities seized 67,291 pounds of marijuana, 2,863 pounds of cocaine, 5.1 pounds of heroin, 30 aircraft, 66 vehicles, and 1 vessel, and made 43 arrests in connection with this operation.

As the number of conveyances entering the United States increases each year, NII technology has and will continue to play a key role in reducing the amount of illegal drugs entering the United States. These systems, such as the Vehicle and Cargo Inspection System (VACIS), Truck X-ray system, Sea Container X-ray system, Rail VACIS, and Heavy Pallet Examination System, scan large conveyances and allow Customs to detect narcotics and other contraband concealed deep within an ever-growing volume of commercial cargo and conveyances. Utilizing this technology, Customs can thoroughly examine more cargo and conveyances while expediting the movement of legitimate cargo.

Customs continues to build upon its 5-year Technology Acquisition Plan to design, develop, and test NII equipment. Currently, there are 96 large-scale NII systems deployed across the country. Twenty-three (23) of these systems were deployed in FY 2002. Thirty-six (36) additional systems were funded under FY 2002 emergency supplemental funds and are expected to be deployed by the end of FY 2003. Increased staffing resources will accompany newly funded NII systems. In FY 2002, NII technology resulted in over

611 seizures totaling more than 272,528 of narcotics. This is a substantial increase from the 307 seizures totaling 226,799 pounds recorded in FY 2001. Customs is currently working on expanding the deployment of NII systems to additional ports of entry located on the U.S./Canadian border.

Performance Measure: Narcotics Seizures

Those who attempt to smuggle narcotics into the United States use a wide variety of smuggling techniques and strategies. They may attempt to conceal the narcotics in various types of conveyances, in cargo, on their person, or in their luggage. They may try to smuggle through a port of entry or between ports. They may be connected with a drug smuggling organization or group, or they may be acting independently. They may be smuggling large amounts of narcotics, small amounts, or anything in between.

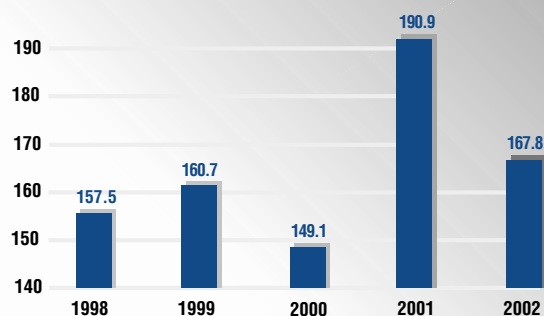
The increased scrutiny of conveyances, cargo, people, and baggage following the September 11 attacks makes it more difficult for a drug smuggler to be successful. Yet, drug smuggling organizations are very creative in developing new strategies to try to circumvent Customs efforts. Customs, in turn, aims to keep one step ahead of the smugglers and, through interdiction, intelligence, and investigation, either deter or seize the narcotics.

Projection: Seize or assist in seizing 200,300 pounds of cocaine, 3,800 pounds of heroin, and 1,579,100 pounds of marijuana.

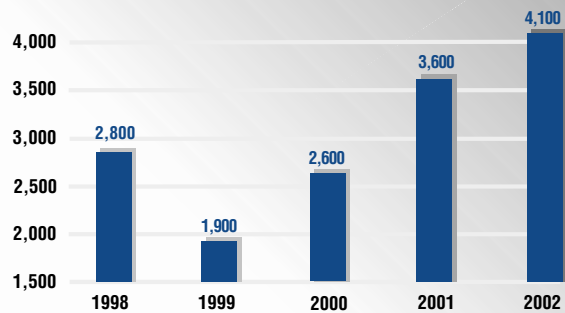
Results: Customs seized or assisted in seizing approximately 167,834 pounds of cocaine, 4,131 pounds of heroin, and 1,374,081 pounds of marijuana.

The weight of cocaine seized was 16.2 percent below the projected amount, the weight of heroin seized was 8.7 percent above that projected, and the weight of marijuana seized was 13.0 percent below that projected. It should be noted, however, that last year's projections were based on past trends, and were established before it was fully evident what the impact would be of the heightened state of alert at the borders following the terrorist attacks of September 11, 2001.

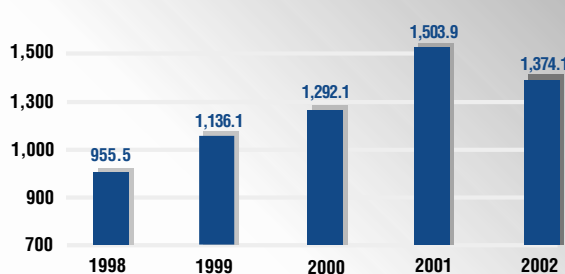
Pounds of Cocaine Seized (in thousands)



Pounds of Heroin Seized



Pounds of Marijuana Seized (in thousands)



In comparison with FY 2001, Customs experienced a 12.1 percent decrease in the weight of cocaine seized, a 14.0 percent increase in the weight of heroin seized, and a 8.6 percent decrease in the weight of marijuana seized. Over the same period, the number of seizures declined for cocaine and marijuana, and increased for heroin. The average size per seizure decreased for cocaine and marijuana, but increased for heroin.

One of the factors contributing to the amount of cocaine seized in FY 2002 is the continued coordination of law enforcement efforts in targeting DSOs operating in and transporting drugs through identified high risk areas, such as the Southwest Border and Florida corridors. Cocaine is smuggled into the United States primarily via the Mexico/Central America Corridor and the Caribbean Corridor.

In FY 2002, U.S. law enforcement targeted a significant smuggling threat involving the use of vessels to transport cocaine to the United States and Europe via EastPac. In response to this threat, Customs initiated a myriad of operations involving air, marine, investigative, and intelligence assets. As a result of extensive patrolling and targeting activity, Customs was involved in a significant number of incidents involving ton quantities of cocaine. Continued targeting and interdiction activity in FY 2002 resulted in an increase in the amount of cocaine seized from vessels in the EastPac, indicating that cocaine smuggling via the EastPac remains a significant smuggling threat to the United States.

The use of couriers traveling via commercial air continues to be the primary heroin smuggling method encountered by Customs. The majority of the heroin seized by Customs in FY 2002 was of Colombian origin, with most transiting directly from Colombia. Colombian traffickers also actively used other South and Central American countries and Mexico to funnel the heroin to American markets, and they have been identified as using well-established cocaine smuggling routes to transport heroin to the United States. Seizures from the major transshipment countries increased dramatically in FY 2002.

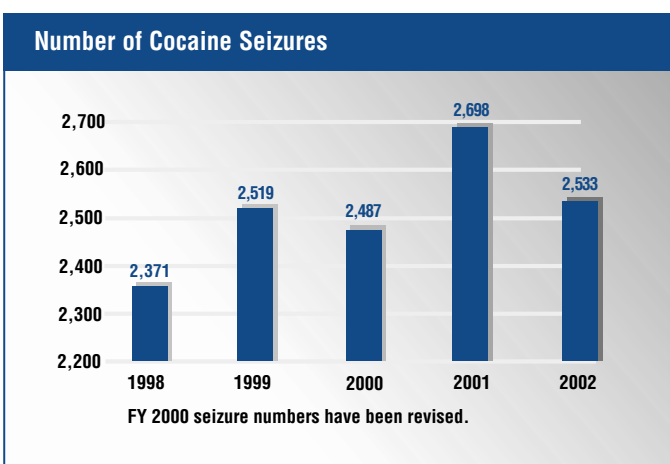
Mexico continues to be the major marijuana source area, with significant seizures being effected along the Southwest Border, the preferred entry point for DSOs. Investigative and intelligence information continues to point to major distribution groups exploiting all available means of conveyance, including the co-mingling of marijuana consignments with legitimate cargo. These groups establish nationwide distribution channels and move consignments from coast to coast.

Jamaica and Canada remain secondary source areas of marijuana destined for markets within the United States. Marijuana from Jamaica is usually transported via maritime conveyance. Locations in the Northwest and Northeast are preferred entry points for marijuana coming into the United States from Canada.

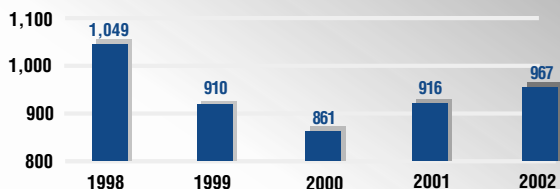
For the past several years, the increase in the smuggling of synthetic drugs has raised significant concern among U.S. law enforcement groups. In FY 2002, Customs made, or assisted in making, 510 domestic methamphetamine seizures totaling 3,119 pounds, compared to 613 seizures yielding 3,185 pounds in FY 2001. Although the number of seizures decreased by 16.8 percent, the total amount seized decreased by only 2.1 percent, thus yielding an increase in the average size of seizures from 5.2 pounds to 6.1 pounds (a 17.3 percent increase). Customs also seized nearly 7.5 million MDMA (Ecstasy) tablets, a 4.2 percent increase over FY 2001. The popularity of this drug among young people remains very strong in the United States.

Projection: Effect at least 2,778 cocaine seizures, 943 heroin seizures, and 15,024 marijuana seizures.

Results: Customs effected or assisted in effecting 2,533 cocaine seizures, 967 heroin seizures, and 13,404 marijuana seizures.



Number of Heroin Seizures



The number of cocaine seizures was 8.8 percent below that projected, the number of heroin seizures was 2.5 percent above that projected, and the number of marijuana seizures was 10.8 percent below that projected. As with the poundage of seizures, it should be noted that last year's projections were based on past trends, and were established before it was fully evident what the impact would be of the heightened state of alert at the borders following the terrorist attacks of September 11, 2001.

Number of Marijuana Seizures



In FY 2002, the number of cocaine seizures dropped by 6.1 percent compared to FY 2001, the number of marijuana seizures declined by 8.1 percent, and the number of heroin seizures increased by 5.6 percent. At the same time, the average pounds per seizure decreased for cocaine from 70.7 to 66.3, increased for heroin from 4.0 to 4.3, and decreased for marijuana from 103.1 to 102.5.



Canines are an important element in Customs Narcotics interdiction work.

Canine Enforcement Program

The Customs Canine Enforcement Training Center, located in Front Royal, Virginia, provides training for all Customs canine enforcement officers and other federal, state, local, and foreign law enforcement agencies. Since its inception in 1970, the Canine Enforcement Program has grown from 6 to 545 working canine teams, currently assigned to 73 ports of entry at major land border crossings, international airports, and seaports. In 1998, the Canine Enforcement Program established a detector dog breeding program to maximize the number of dogs suitable for detection training. The program, modeled after the Australian Customs Service Program, has bred 13 litters to date. Customs Canine Enforcement Program is responsible for a significant proportion of narcotics seizures, accounting for more than 8,487 narcotics seizures totaling over 636,688 pounds of narcotics in FY 2002. It was also involved in \$27.2 million in currency seizures in FY 2002.

CRIMINAL FINANCE

Goal: Strengthen domestic and international efforts to disrupt the flow of illegal money derived from global criminal activity.

This goal ties directly to the Commissioner's priority investigative goals of expanding Customs efforts to investigate and disrupt terrorist financing through Operation Green Quest and to increase Customs effectiveness in investigating and enforcing federal criminal laws related to money laundering.



Smuggled currency hidden in an ice chest.

OVERVIEW

The objective of the Criminal Finance Program is to identify, disrupt, and dismantle the financial systems used by criminal organizations — especially those with a nexus to terrorism — to launder funds illegally generated by smuggling, trade fraud, export violations, and other criminal activity. Customs jurisdiction in combating global financial crime is triggered by the movement of illicit funds, services, or merchandise across U.S. borders and is applied pursuant to the authority included in the Bank Secrecy Act, the Money Laundering Control Act, the USA PATRIOT Act of 2001, and other customs laws. Customs criminal finance investigative activities address the challenges and priorities set forth in the FY 2002 National Money Laundering Strategy, to which Customs is a major contributor.

Customs Criminal Finance Program employs a multi-faceted approach to combating money laundering, including:

- Leading Operation Green Quest, a multi-agency initiative to identify, disrupt, and dismantle sources of terrorist funding;
- Coordinating/monitoring six high risk money laundering and related High Intensity Financial Crime Area (HIFCA) task forces, which concentrate law enforcement efforts at the federal, state, and local levels to combat major criminal organizations and systems in high crime areas;
- Supervising and monitoring eight Money Laundering Multidisciplinary Teams (comprised of special agents, analysts, and inspectors) that focus on threats affecting their specific regions;
- Conducting bulk cash smuggling/outbound operations, targeting the illegal exportation of unreported currency derived from criminal activity;
- Conducting undercover operations to dismantle major money laundering organizations/systems, including the Black Market Peso Exchange (BMPE), the largest trade-based money laundering system in the Western Hemisphere;
- Operating 21 Asset Identification and Removal Groups, which target the assets of criminal organizations at the onset of investigations;
- Conducting anti-telemarketing fraud operations in coordination with Canadian law enforcement officials;
- Providing training and technical assistance to bolster the anti-money laundering capabilities of foreign law enforcement officials;
- Conducting outreach to financial institutions and businesses to enlist their participation in the battle against illegal money laundering; and
- Providing training for agents from other federal, state, and local law enforcement agencies.

CHALLENGES

The major criminal finance challenges facing Customs today are:

- Identifying, disrupting, and dismantling terrorist financing networks;
- Implementing and promoting utilization of the powerful new anti-money laundering regulatory measures which were made available by enactment of the USA PATRIOT Act;
- Focusing investigative efforts on the prosecution of major money laundering organizations and systems and their leaders;
- Enhancing cooperation between public-private entities to leverage resources dedicated to preventing money laundering;
- Bolstering the capabilities of foreign governments to combat international money laundering and terrorist financing on a global scale;
- Improving coordination with state and local law enforcement agencies to strengthen anti-money laundering efforts nationwide; and
- Developing strategies to counter technological advances in money laundering, such as Internet money transfers and new payment technologies – e-cash, electronic purses, and smart-card based electronic payment systems.

Customs is addressing these challenges in many ways, as described below.

Following the terrorist attacks on September 11, 2001, the U.S. Government recognized the need to increase its efforts to identify, disrupt, and dismantle the sophisticated international financial systems and infrastructures used by terrorist organizations to fund their activities. These systems may utilize legitimate enterprises and charities/relief organizations as well as illegal enterprises to divert money to terrorists. Operation Green Quest, a Customs-led multi-agency Treasury initiative dedicated to this purpose, was established to address this critical challenge. Aggressively drawing upon the full resources and expertise of the Treasury and Justice Departments, and many other federal agencies, Green Quest's command and coordination function is responsible for collecting, managing, and disseminating leads to field agents and serving as a coordinating mechanism for financial investigative activity related to terrorism.



A key component of Customs anti-terrorism strategy is the expansion of Operation Green Quest.

Enactment and implementation of the USA PATRIOT Act has provided law enforcement entities with an array of tools and enforcement mechanisms to facilitate anti-money laundering investigations and prosecutions. These include registration of money service businesses, required reporting of suspicious transactions by money service businesses and securities brokers/dealers, access to foreign correspondent bank records, and stringent criminal penalties for bulk currency smuggling. Customs is utilizing these new information sources and enforcement provisions to enhance the effectiveness of its criminal finance investigations. In addition, implementation of new outbound mail legislation will enable Customs to close the loophole on potential terrorist-supported and other illegal funds being transmitted out of the country via the U.S. mail.

Customs will continue to focus investigative efforts on the prosecution of major money laundering organizations and to coordinate law enforcement efforts with state and local governments. The agency will work to enhance the effectiveness of the six HIFCA task forces. These task forces are currently investigating bulk cash smuggling, money service businesses, illegal trade in precious metals, wire remitters, drug trafficking-related money laundering, and suspected financing of terrorist activities. Additionally, Money Laundering Multidisciplinary Teams, recently established at eight Customs field offices, have already begun to focus their analytical expertise on identifying patterns and trends, and developing investigative strategies to address threats that impact their geographical areas. Customs will also continue its efforts to dismantle the BMPE through a vast network of undercover and joint operations supported by the Money Laundering Coordination Center and will continue to provide training and technical assistance to foreign law enforcement officials.

Recognizing that money laundering and terrorist financing are global concerns, Customs will continue to provide international training on the Bank Secrecy Act, the Money Laundering Act, and other regulatory measures related to banking in its efforts to bolster the capabilities of foreign

governments to combat international money laundering and terrorist financing.

ANALYSIS OF PERFORMANCE

Customs aggressive strategy to combat money laundering during FY 2002 involved interdiction efforts, criminal investigations, intelligence analyses, and partnership with numerous governmental entities, both domestic and foreign, and with the trade community to enhance the enforcement of Customs-related criminal finance laws.

Additional funding received through the FY 2002 Emergency Supplemental and the redirection of base resources in several core anti-money laundering programs during FY 2002 resulted in increased effectiveness. The creation of Operation Green Quest and Operation Oasis, a Customs outbound bulk currency initiative coordinated by Green Quest, contributed to Customs results. Funds were secured to support the needs of the six HIFCAs targeting major criminal organizations and systems in high crime areas. Staffing assignments were finalized for the Money Laundering Multidisciplinary Teams.

On the international front, in FY 2002, training was provided at International Law Enforcement Academy sites in Hungary, Thailand, and Botswana, while foreign law enforcement officials from the Caribbean, France, Italy, Russia, Panama, Egypt, Lebanon, Qatar, Uruguay, Switzerland, China, and the United Kingdom attended sessions at Customs Headquarters in Washington, DC. Customs will continue working with Colombian law enforcement officials on money laundering cases, such as the BMPE, bulk cash, and investment schemes.

As discussed below, statistics for FY 2002 show a substantial increase in the value of both monetary instrument seizures and property seized in connection with financial investigations.

Projection: Seize or assist in seizing at least \$95 million in total monetary instruments.

Results: In FY 2002, Customs seized or assisted in seizing \$274.3 million in total monetary instruments.



Over \$6 million was concealed in stereo speakers.

The value of monetary instruments seized for FY 2002 was \$274.3 million, or 188.7 percent above the projection for FY 2002 and 69.3 percent above the \$162 million reported for FY 2001.

Many factors contributed to this substantial increase. Several highly productive investigations, begun in previous reporting periods, were concluded in FY 2002; the aggressive anti-terrorism efforts that Customs implemented following the events of September 11, 2001, led to the creation of a major terrorist financing initiative, Operation Green Quest, and to Operation Oasis, which expanded resources devoted to investigating financial and money laundering cases and yielded commensurate results; and implementation of the USA PATRIOT Act provided a wide array of new enforcement tools (e.g., registration of money service businesses and wire transmitters, new criminal penalties for bulk cash smuggling, and new reporting requirements for nontraditional financial organizations) to bolster the effectiveness of anti-money laundering efforts.

Projection: Seize \$60 million in unreported currency being exported from the United States. This is included in overall monetary instruments above, but also constitutes a separate performance goal of its own.

Results: Customs seized \$45.2 million in unreported currency being exported from the United States during FY 2002.

The value of unreported currency seizures in FY 2002 was \$45.2 million. The amount is 24.7 percent below the FY 2002 projection, but only 3.8 percent below the amount seized in FY 2001. In FY 2002, 1,390 seizures were made,

an increase of 191, or 15.9 percent, over FY 2001. The lower than projected figure for the value of unreported bulk currency seizures may be attributed, at least in part, to the aggressive security measures implemented by the Transportation Security Administration at major international airports. Smugglers may also be exporting smaller shipments of bulk currency to minimize their losses in the event of seizure.

The results of bulk currency seizures related to Customs anti-terrorism operations (i.e., the Operation Green Quest Bulk Currency Initiative, formerly Operation Oasis) represent 41 percent of the total unreported currency being seized.

Projection: Seize at least \$25.5 million in real and other property as a result of money laundering investigations.

Results: In FY 2002, Customs seized \$36.7 million in real and other property as a result of money laundering investigations.

The value of property seized in connection with financial investigations was \$36.7 million, or 43.9 percent above the FY 2002 projection, and 90.2 percent above the \$19.3 million reported for FY 2001. The aggressive enforcement efforts that Customs implemented following the terrorist attacks of September 11 contributed to that increase. Implementation of the USA PATRIOT Act with its tighter provisions regarding forfeiture of terrorist assets, greater awareness and utilization of specialized Asset Identification and Removal Groups, and improved coordination with federal, state, and local law enforcement agencies are additional factors contributing to the favorable results of FY 2002.

Operation Green Quest: Anti-Terrorism Related Money Laundering

In pursuit of its objective to identify, disrupt, and dismantle financial systems and infrastructures which support terrorist funding, Operation Green Quest utilizes the full array of law enforcement techniques, including undercover operations, electronic surveillance, outbound currency operations, and the exploitation of intelligence data, financial data, trade data, and confidential source data. From its inception in October 2001 through September 30, 2002, Operation Green Quest has initiated 859 financial investigations involving suspected terrorist financing and referred 1,109

leads on potential terrorist financial activities to domestic and foreign offices. Investigations coordinated by Operation Green Quest have resulted in 47 arrests, 28 indictments, and 6 convictions to date. In addition, Operation Green Quest has seized a total of \$25.9 million: \$7.3 million from the investigations it coordinated and \$18.6 million from Operation Oasis, an interdiction initiative targeting bulk cash smuggling by terrorist organizations. Operation Oasis has been coordinated by Green Quest through Customs inspectors at the nation's international airports, land ports, and seaports.

Financial Crimes Operations

The following are several examples of successful and ongoing criminal finance task force operations in which Customs inspectors, agents, and others participated:

- Operation Wire Cutter, a 3-year undercover operation targeting the largest Colombian BMPE money brokers, resulted in the arrests of 47 people in the United States and Colombia, and the seizure of \$8.2 million in cash, 882 pounds of cocaine, 205 pounds of marijuana, and 14 pounds of heroin. Operation Wire Cutter marked the first time that U.S. authorities were able to combine undercover pickups of drug proceeds in this country with investigative efforts by Colombian authorities to target BMPE money brokers. By coordinating their resources, authorities in both countries were able to monitor the money laundering process "full circle"—watching drug funds enter the system in the United States and exit the system in Colombia.
- In June 2002, charges were filed against an international banker from New Jersey and a Brazilian currency exchange business in connection with a money-laundering scheme that moved \$2 billion. Following a drug investigation and cocaine seizure at Newark Airport, Customs agents identified suspicious accounts at a New York bank. Further investigation revealed that an Assistant Vice President for international private banking controlled the accounts. The subject maintained more than 250 accounts at the bank, 44 of which were in the names of non-existent companies and people that were fronts for Turist-Cambio and other currency exchange firms in Brazil. Using these accounts, the subject illegally wire transferred hundreds of millions of dollars



Over \$77,000 was hidden in the elastic bandage.

on behalf of these firms. In addition to the arrests, Customs agents seized over \$20 million from accounts at the bank.

- Based upon information received from a financial institution in Phoenix, AZ, a case was initiated in January 2002, regarding a bank that had opened a brokerage account with the financial institution, claiming to be investing American Indian trust funds. After the financial institution performed “due diligence,” it learned that the bank was not legitimate, closed the account, and notified Customs. Customs determined that the bank was promoting a fraudulent investment scheme and seized a total of \$30.2 million from its accounts held at banks in Phoenix and in Cincinnati, OH. The Securities and Exchange Commission has issued a restraining order on the bank.

- A Customs-initiated OCEDEF investigation initiated in May 1998, “Get Shorty,” targeted a Mexican-based cocaine smuggling, transportation, distribution, and money laundering organization which was smuggling cocaine into the United States via the Mexico/Texas land border. The organization was found to have cells located along the Southwest Border and in most major cities in the Southwest, Central, and Northeast United States. To date, “Get Shorty,” and concurrent investigations, have netted seizures of \$4.5 million in proceeds, more than 1,751 pounds of cocaine, and 1,015 pounds of marijuana. The operation resulted in 24 arrests, 21 indictments, and 11 convictions, with additional indictments pending at the end of September 2002.

PUBLIC PROTECTION



Customs uses modern methods to track and target goods for examination.

Goal: Contribute to a safer America by reducing terrorist, criminal, and civil activities associated with the enforcement of customs laws.

This goal ties directly to the Commissioner's priority investigative goals of: expanding Customs efforts to investigate and disrupt terrorist financing through Operation Green Quest and to disrupt terrorist access to high-tech weaponry and equipment through Project Shield America; and increasing Customs effectiveness in investigating and enforcing federal criminal laws relating to money laundering, cybercrime, and customs fraud.

OVERVIEW

The terrorist attacks of September 11, 2001, catapulted the American public to a new level of awareness and concern for the safety of America. The unthinkable had become a reality. The definition of a safer America took on new meaning, and elevated all initiatives aimed at identifying, disrupting, dismantling, preventing, and “de-funding” terrorists and terrorist organizations to the highest priority. As the first line of defense at our nation's borders, Customs top priority mission is to protect the American public from international terrorism. Customs objectives in this regard are to protect the American public from the introduction of Weapons of Mass Destruction (WMD) and other instruments of terror into the United States from abroad, and to prevent international terrorists from obtaining WMD materials and technologies, arms, funds, and other support from U.S. and foreign sources.

Other objectives to contribute to a safer America are to: reduce potentially hazardous, harmful, and/or life threatening situations caused by the importation of forbidden or illegal commodities; enforce embargoes and sanctions imposed by the United States Government against foreign countries; prevent the exportation of stolen property, including stolen vehicles; increase export compliance; serve and protect the public through innovative and sophisticated computer-based investigations which disrupt illegal activity being facilitated across the United States borders via the Internet; and safeguard children and other vulnerable persons from human exploitation.



Customs uses mobile x-ray vans to inspect cargo wherever needed.

CHALLENGES

There are many key challenges associated with the Customs mission of protecting the American public. One major challenge is to prevent proliferant countries, terrorist groups, and criminal organizations from obtaining weapons of mass destruction and related technologies, conventional munitions, and firearms. Another major challenge is to identify and cut off the sources of funding which support the operations of terrorist groups. New technologies must be developed and implemented in the inspection and investigation arenas to deal with changing smuggling and money laundering trends and techniques, and partnerships must be forged with other agencies, other countries, and the private sector to identify and rout out the would-be killers of our American citizens/guests and our society.

Other challenges involve: identifying imports that would be harmful to the public health and seizing them before they cause harm; dealing with the inconsistencies of different countries' laws and practices when investigating international crimes; and remaining current in the rapidly expanding cybercrime arena.

In an attempt to address these challenges Customs:

- Initiates programs to partner with the trade community to safeguard commerce from being an unwitting vehicle for terrorist activity;
- Leads or participates in multiagency and international efforts;
- Develops initiatives to increase security on the Northern Border;

- Seeks to identify, disrupt, and dismantle financial systems and infrastructures which fund terrorism and terrorist activities;
- Develops and utilizes new technology to detect contraband;
- Provides on-going foreign border control training and education programs in the areas of weapons of mass destruction, firearms trafficking, and exports of stolen vehicles;
- Seeks to intercept products which may be harmful to the public health and safety; and
- Maintains state-of-the-art cybercrime-fighting skill sets and technology.

ANALYSIS OF PERFORMANCE

Disruption of International Trafficking and Terrorist Activities

Project Shield America. Project Shield America was initiated by Customs on December 4, 2001, to partner with U.S. industry to prevent their technological products from being exploited and acquired by terrorists and terrorist sponsoring nations. This major enforcement program is designed to elicit industry cooperation and to stop the illegal exportation of U.S. munitions list items and strategic dual-use technology having sensitive civil and military applications. In FY 2002, approximately 4,300 businesses were contacted, resulting in over 50 leads.

Joint Terrorism Task Forces (JTTFs). The FBI is the lead agency for enforcement of federal terrorism statutes. In support of this mission, JTTFs utilize the collective resources of federal, state, and local law enforcement agencies for the prevention, preemption, deterrence, and investigation of terrorism and activities related to terrorism, both actual and potential, occurring in or affecting the United States, carried out by terrorist groups and/or individuals, as well as apprehending individuals committing such violations. Customs participates in all 56 JTTFs.

Customs Trade Partnership Against Terrorism (C-TPAT). Customs has established C-TPAT as a joint, government-business initiative to develop and sustain a secure supply chain while maintaining a high level of trade compliance that provides reliable cargo release targeting data. C-TPAT's goal is to enable Customs to ensure safe and secure borders

against terrorism while ensuring the efficient release of cargo and the prompt resolution of issues affecting C-TPAT participants. C-TPAT uses and enhances the security processes currently employed by the trade community to assure that international shipments are not compromised or diverted by terrorists or their accomplices.

Container Security Initiative (CSI). The purpose of the CSI program is to enhance security in maritime trade by screening sea containers before they reach the United States. The fundamental idea behind CSI is to engage the foreign ports that ship the greatest number of containers to the United States, as well as the governments in these locations, in a cooperative effort to target high-risk containers and facilitate detection of potential problems at the earliest possible opportunity, thereby substantially reducing the risk of a catastrophic event involving the use of seagoing containers. Initially implemented in partnership with Canada, the program currently has Customs personnel stationed in the Canadian seaports of Halifax, Montreal, and Vancouver, and in Rotterdam, the Netherlands. The top 20 ports that export to the United States collectively account for nearly 70 percent of all the containers entering the country; Customs goal is to implement the CSI in each of these ports, as well as in a number of other ports which pose a significant potential threat. To date, in addition to the two countries and four ports mentioned above, France, Belgium, Germany, Hong Kong, Singapore, and Japan have agreed to allow Customs inspectors to prescreen U.S.-bound cargo at the ports of Le Havre, Antwerp, Bremerhaven, Hamburg, Hong Kong, Singapore, Kobe, Yokohama, Tokyo, and Nagoya.



A container ship docks at the Miami seaport.



Customs protects the American public against intrusion of dangerous substances and contraband.

Integrated Border Enforcement Teams (IBETs). In 2002, IBETs continued to become operational along the shared border of the United States and Canada. IBETs are comprised of Customs special agents working alongside agents and officers from several other U.S. and Canadian law enforcement agencies in an international effort to combat terrorism and other types of criminal activity along the border. As of August 2002, nine IBETs were operational along the shared U.S./Canadian border, operating as intelligence-driven teams to deter criminal organizations that have historically utilized the expanse of the Northern Border to smuggle people, merchandise, and contraband into the United States and Canada.

Treasury Forfeiture Fund (TFF). Through the use of the TFF, Customs has been able to utilize state and local law enforcement personnel as “force multipliers” during Customs-sponsored joint enforcement operations. The TFF enables Customs to reimburse state and local law enforcement agencies for overtime expenses incurred while their officers assist Customs inspectors in conducting inbound and outbound operations. As a result of the \$2 million Customs received from the TFF during FY 2002, a total of 100 contracts were established with an estimated 1,000 state and local officers working with Customs personnel on the highways and in the jetways across the country. The \$2 million was distributed to 16 CMCs based on seizure activities for core areas of currency, stolen vehicle, and EXODUS violations.

Intelligence. Since September 11, 2001, the Customs Intelligence Division has reoriented its assets and resources toward producing anti-terrorism intelligence, devoting almost all of its assets to developing information on terrorist groups. Using Operation Border Shield, the Intelligence Division has produced over 2,000 lookouts and over 700

intelligence reports and alerts. The Division has also been one of the key contributors and developers of the CSI and C-TPAT.

Investigations. In FY 2002, Customs opened 2,210 strategic investigations cases. Investigative efforts significantly disrupted illegal international trafficking in munitions and dual-use technologies, which are particularly vulnerable to being used in terror-related activities. Such trafficking includes the illegal export of such items as military aircraft and missile parts, unmanned aerial vehicle components, night vision equipment, munitions items, and fiber optic gyroscopes. Strategic investigation successes include:

- In February 2002, a Swiss national pled guilty in the Eastern District of New York to a single count of violation of the Arms Export Control Act. In the plea agreement, the defendant agreed not to contest the forfeiture of \$107,000 seized in the District of Arizona. In a post arrest statement, the subject told the agents that he had been trading U.S.-origin aircraft parts with Iran for approximately 10 years, doing an annual average business of \$1.5 million. He also admitted to selling Russian armored personnel carriers and supporting the Mig-21 fighter in the Middle East. On July 18, 2002, he was sentenced to 30 months in prison, three years probation, and a \$10,000 fine.
- In April 2002, a federal jury sitting in Philadelphia, Pennsylvania, returned a verdict of guilty against a corporation, several corporate officers, and an employee for conspiracy to violate the Trading with the Enemy Act and Cuban Asset Control Regulations. The jury also found the company president guilty of 34 of the 76 counts of specific transactions that violated the Cuban embargo.
- In April 2002, after a long-term undercover investigation, two individuals were convicted in federal court in Baltimore, Maryland, of violation of the Arms Export Control Act relating to a sophisticated plot to illegally export controlled encryption devices to the People's Republic of China.



Customs enforces over 400 laws, assisting other federal agencies in protecting the American public.

Detector Dogs. The Canine Enforcement Training Center, located in Front Royal, Virginia, provides training for all Customs canine enforcement officers, as well as other federal, state, local, and foreign law enforcement agencies. During FY 2002, the Canine Enforcement Program began development of two new programs — the Explosive Detection and Chemical Detection programs — which are designed to enhance Customs anti-terrorism efforts. Pilot programs have been approved and continue to be developed for selected ports.

Combating Terrorist Financing

Following the terrorist attacks of September 11, an unprecedented focus was placed on identifying, disrupting, and dismantling the financial systems and infrastructures used by terrorist organizations to support their terrorist activity. Operation Green Quest was formed as a Customs led multi-agency Treasury initiative which uses existing statutes and newly enacted anti-terrorism statutes to target systems and organizations that raise and move funds for terrorist groups. Green Quest serves as the command and coordination center for coordinating and disseminating financial terrorist investigative leads to field agents.

From its inception in October 2001, through the close of FY 2002, Green Quest has initiated 859 financial investigations involving suspected terrorist financing and referred 1,109 leads on potential terrorist financial activities to domestic and foreign offices. During that same period, Green Quest's financial investigations have resulted in 47 arrests, 28 indictments, 6 convictions, and the seizure of \$7.3 million. In addition, Operation Oasis, a Customs outbound bulk currency interdiction initiative coordinated by Operation

Green Quest, has resulted in total seizures of \$18.6 million worth of smuggled currency and monetary instruments. The Intelligence Program provided support to several financial investigations, including Operation Green Quest and Operation Oasis, as well as to all major terrorism-related programs.

In FY 2002, the IPR Center initiated an investigation involving various U.S. importers shipping counterfeit wearing apparel from Lebanon. Pursuant to information developed by the IPR Center, Green Quest has accepted the case based on substantiated terrorist connections. The IPR Center has initiated a second investigation with suspected links to terrorism.

Cigarette smuggling in Canada, Mexico, and Europe has attracted transnational organized crime groups, and some international terrorist groups have been linked to organized cigarette smuggling as a means of raising funds. Working with European counterparts, Customs has identified persons operating from the United States who are linked to several organized crime groups.

Securing America's Air Space

During the days immediately following the terrorist attacks of September 11, Customs Air Program provided numerous flights to support the transportation needs of Customs and other federal law enforcement agencies, ensuring that critically needed personnel and equipment were transported throughout the United States; provided seamless radar coverage and was an integral player in reestablishing airspace security in our nation's skies; and supported the North American

Aerospace Defense Command (NORAD) by providing radar coverage over portions of the eastern seaboard. The Air Program continues to support Homeland Security initiatives by providing both air and marine patrols; working with the North American Aerospace Defense Command to monitor the borders of the United States and to assist in the tracking and identification of any suspect aircraft; providing surveillance and transportation in support of the FBI, Bureau of Alcohol, Tobacco and Firearms (ATF), and Secret Service counterterrorism operations; and participating in interagency groups planning homeland air security strategies and an air security plan for the National Capital Region.

Safety of the 2002 Winter Olympic Games

In keeping with Presidential Decision Directive 62 (PDD-62), Customs detailed 202 special agents, 110 inspectors, and 122 air and marine personnel to augment the Olympic security mission for the 2002 Winter Olympic Games in Salt Lake City, Utah. The special agents provided standing security at Olympic venues on a 24 x 7 basis. Air and marine personnel worked with the Federal Aviation Administration (FAA), the Secret Service, the DOD, and other federal agencies to coordinate the air security mission, and with DOD to enforce the 45-mile radius around Salt Lake City that was designated as a restricted flying zone. A total of 35 targets of interest were investigated by Customs during the games. The Air and Marine Interdiction Coordination Center (AMICC) provided long-range surveillance of the Olympic airspace and conducted more than 8,000 background and criminal history checks on general aviation pilots and passengers flying into Salt Lake City. Customs inspectors also worked with the Secret Service and the FAA to provide heightened security at six airports and several command centers. The inspectors used high technology equipment to search each aircraft; swabbed planes to test for chemicals that could be used in explosive or biological weapons; used magnetic wands to search passengers; x-rayed every single piece of baggage; and used radiation detectors on every plane, passenger, crewmember, and bag. Inspectors used the passenger information that AMICC supplied daily to determine which flights merited closer examination. The efforts of all these Customs personnel helped to make the XIX Winter Olympics Games one of the safest in Olympic history.



The Air Program continues to support Homeland Security by providing air patrols.

Improving Customs Infrastructure

Customs continues to act as the focal point for the planning, development and implementation of interoperable communications in support of the anti-terrorism mission along the Northern Border. Customs tactical communications program hosted the first two meetings of the Inter-Agency Border Security Communications Working Group (consisting of U.S. and Canadian border agency communications officials) and participated in the third meeting, which was hosted by the Royal Canadian Mounted Police in September 2001. These meetings address current and projected operational requirements, bilateral frequency coordination, the tactical communications capabilities of each agency, and other tactical communications considerations. This will potentially leverage the existing Northern Border tactical communications resources of the border agencies. With counterterrorism funding received in FY 2001, Customs has completed the upgrade of the tactical communications network infrastructure and subscriber equipment in the Blaine/Bellingham, WA, area.

Public Health

A key responsibility of Customs is protecting the public from the introduction into the United States of chemicals and substances which are hazardous to health or safety, or which are damaging to the environment. In one significant case, Customs laboratory analysis found chloramphenicol in samples of bulk Chinese honey that was being detained at a Los Angeles port. Chloramphenicol, a potentially harmful antibiotic and unapproved food additive, is banned by the FDA in food-producing animals, including honeybees, because about 1 in 30,000 persons exposed to it develops idiosyncratic aplastic anemia, a potentially life-threatening blood disorder. Honey shipments that tested positive for chloramphenicol were seized, and several other suspect shipments were detained for sampling and testing by the FDA. As of the end of August 2002, the investigation resulted in the detention of more than 50 containers of bulk Chinese honey at U.S. ports. No illnesses related to the imported honey have been reported. Customs is stopping all suspect bulk honey imports for testing and continuing the investigation.

Disruption of CyberSmuggling Activities and Organizations

During FY 2002, the Customs CyberSmuggling Center (C3) utilized its in-depth understanding of and facility with the Internet to combat civil and criminal activity against Americans and American property in areas such as child exploitation, child pornography, child sex tourism, violations of IPR, fraud, money laundering, terrorist financing, counterterrorism, and the theft of cultural heritage property. Additionally, the computer forensics function performed by the C3 assists in the recovery of digital evidence in support of legal prosecutions of criminal activity. Given the global nature of illegal Internet activity, C3 is forging an expanding base of international relationships with foreign law enforcement agencies.

As a result of the tragic events of September 11, the C3 is actively engaged in anti-terrorist activities, including support of Operation Green Quest from a cyber perspective for the identification and tracking of currency transactions of terrorist organizations. Further, the C3's forensics unit has examined and provided expert analysis of digital storage devices recently seized during anti-terrorist sweeps.

C3 investigations successes this past year include:

- Operation Hamlet, a Customs-led worldwide investigation, focused on a ring of pedophiles who sexually molested children and distributed child pornography over the Internet. Many of those involved were parents who molested their own children. To date, 45 children have been rescued and 22 violators have been arrested, including a school counselor, a chiropractor, a computer technician, and a photographer.
- In Operation Artus, a joint effort with the German National Police, Customs arrested eight Americans who were members of an Internet pedophile ring calling themselves the "roundtable." These individuals, who communicated via Internet Relay Chat Channels, were required to produce new, DVD-quality, child pornographic material in order to participate in the group. Forty-six defendants were identified and arrested worldwide, shutting down the Internet relay chat group.

- C3 is taking action to house the National Child Victim Identification Program information system. Dynamic in nature and containing all known and unique child pornographic images, this system will be the only one of its kind in the United States. In coordination with the National Center for Missing and Exploited Children, the C3 will use this system to support child exploitation investigations and prosecutions conducted by federal, state, local, and foreign law enforcement entities.
- Operation Buccaneer is a Customs-led worldwide investigation into an intellectual property theft ring which pirated several hundred millions of dollars of software. As of August 2002, 75 search warrants were executed worldwide, resulting in the seizure of 232 computers, some of which contained in excess of one terabyte (equal to 700,000 3.5 inch diskettes) of information. To date, approximately 15 terabytes of digital evidence are being handled by the investigators. Of the 18 defendants who pled guilty in the United States, 8 have received sentences ranging from 30 to 46 months – the stiffest sentences handed down in an IPR case to date. The typical defendant has stipulated to being responsible for pirating between \$2.5 million and \$5 million worth of software. Seven additional subjects of the investigation are pending pleas. In addition, six subjects were formally charged in the United Kingdom. According to the Department of Justice, Operation Buccaneer represented the most significant “Warez”/Internet piracy investigation to date.

Quantifiable Performance Measures for Public Protection:

(1) *Interdiction of Stolen Vehicles*

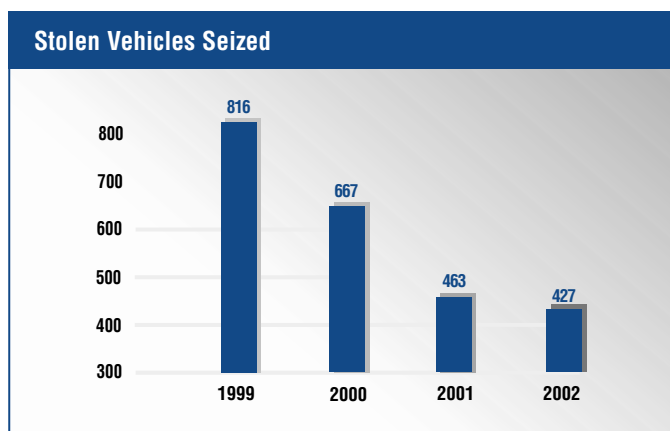
To interdict outbound stolen vehicles, Customs checks outbound vehicles for Vehicle Identification Number (VIN) switches and altered title documents.

Projection: Seize at least 475 outbound stolen vehicles.

Results: A total of 427 outbound stolen vehicles were seized.

A total of 427 outbound stolen vehicles, valued at \$5.1 million, were recovered in FY 2002. This is 10.1 percent below the projected level and 7.8 percent lower than the FY 2001 level. Post September 11 priorities have resulted in less staffing being available to conduct comprehensive vehicle identification of stolen vehicles, VIN switches, and altered title documents. The reduction in staff has had a direct affect on the number of stolen vehicles recovered and other violations discovered. Additionally, changes in smuggling techniques have made detection of illegal vehicle exports increasingly difficult and labor intensive. Techniques include the containerization of the vehicles and inclusion of household/personal effects in the container. To inspect the vehicles, the container must be devanned.

Customs is continuing to expand electronic reporting and its enforcement partnership with the National Insurance Crime Bureau (NICB) and the FBI. The NICB supplied data entry officers and vehicle identification specialists to augment their special agents who are working in the field with Customs inspectors to identify stolen vehicles prior to export.



During FY 2002, Customs and NICB conducted four advanced automobile theft interdiction classes at the Federal Law Enforcement Training Center (FLETC). A total of 96 inspectors and agents were trained in the identification of fraudulent titles, altered VINs, identification of construction equipment and motorcycles, and Customs regulations regarding vehicle exports.

Customs and NICB have entered into an agreement whereby NICB receives raw data feeds collected by outbound LPRs. This will allow NICB to initiate recovery initiatives to repatriate stolen vehicles that have been exported to Mexico.

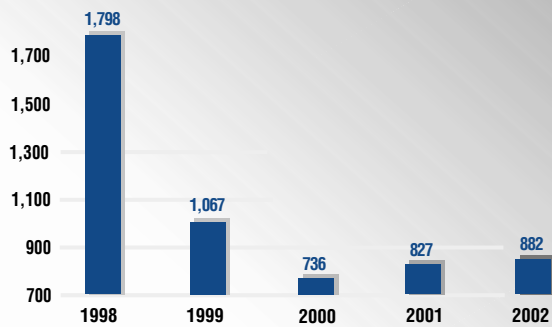
(2) Reducing Outbound Licensing Violations

Seizures of licensing and technical violations reflect improved targeting techniques being utilized by the inspectors doing examinations on export cargo. They also reflect a shift in priority toward targeting for license violations, particularly military goods.

Projection: To make a combined 730 seizures of munitions, technology, and sanctioned shipments.

Results: Customs seized a total of 882 shipments of munitions, technology, and sanctioned goods. The value of these shipments was \$67.7 million.

Outbound Licensing Violations



Customs uses high tech devices to detect violations.

This is a 6.7 percent increase over FY 2001 for the total number of shipments seized, and a 21.1 percent decrease over FY 2001 for the total value of the shipments.

The number of technical or SED seizures fell from 818 for FY 2001 to 600 for FY 2002. This 26.7 percent decrease in the number of SED seizures is also attributed to the redeployment of outbound personnel and the relative nature of the violation.

MANAGEMENT ACCOUNTABILITY

GOAL: Build a strong and effective management support structure that assures the achievement of business results.

Support for Customs mission comes from a number of important functional areas that include:

Human Resources Management
Equal Employment Opportunity
Training
Financial Management, and
Information Technology

These areas have developed ongoing strategies, goals, and objectives to improve mission support to help Customs to become a world-class organization.



Customs has embarked upon a major modernization of its information systems.

HUMAN RESOURCES MANAGEMENT

Customs Human Resources Management (HRM) develops and implements strategies to hire, promote, and retain a diverse, high-quality workforce; and enhance employees' effectiveness, health, and safety.

Strategic Recruitment

HRM played an important role in supporting Customs mandate for increased security at critical borders and keeping terrorists and terrorist weapons out of the United States. In response to new threats, hiring under the agency's Quality Recruitment Program was greatly accelerated, resulting in 2,300 new inspectors, canine enforcement officers, and special agents. As a result of this hiring process, Customs employees sent to the Northern Border for temporary duty after the terrorist attacks of September 11 were able to return to their regular duty stations. In addition, Customs operations continued without problems when the National Guard, who had been helping with border duties, ended their assignments in the fall of 2001.

Customs used hiring flexibility, including the Office of Personnel Management's approval for the waiver of dual compensation for re-employed annuitants, and delegated authority to use the Federal Career Intern Program (FCIP), to fill Northern Border positions in remote locations. Nearly 1,100 same-day tentative selections for inspector positions were made under FCIP. In addition, Customs administration of the Treasury Enforcement Agent examination reduced the cycle time for hiring special agents.

The Customs National Intern Program continues to provide excellent potential Customs officers; 24 college students with diverse backgrounds completed the requirements for the Customs National Intern Program and were converted to inspector and special agent positions. Customs hired 27 interns to begin in FY 2003.

The National Recruitment Strategy for key operational positions continued to be implemented using a network of 250 collateral duty recruiters. In an effort to attract a diverse pool of applicants and increase representation in specific minority groups, a total of 341 recruitment events were conducted, including 305 targeted recruitment events plus 36 Open Houses. In addition, 11 interactive, multi-media recruitment kiosks have been deployed to historically black colleges and universities and Hispanic serving institutions.

HRM continued its emphasis on simplifying hiring processes, providing more objective systems that are easy to access and use, and improving customer service. Customs employment processes are gradually moving from the traditional narrative, essay writing applications to the use of various types of tests and assessments. Quality recruitment has been an excellent program for attracting and hiring inspectors, canine enforcement officers, special agents, and pilots. A variety of assessment tools were utilized for promoting GS-14 special agents. This was further expanded this year to include supervisory inspectors as well as potential managers for the management development and candidate development programs. This year's greatest accomplishment was the implementation of CareerFinder, a web-based application system that is the future for hiring and promoting. CareerFinder eliminates paper applications. After applicants respond to a series of questions on the Internet, the system qualifies and rates applicants so that an electronic selection certificate can be sent to the hiring manager. The system also provides applicants with acknowledgement and status notifications. Almost 1,000 selections through CareerFinder were made for a wide variety of positions.

Succession Management

Customs, like other federal agencies, has an aging workforce. However, programs are in place to ensure adequate staffing levels from entry through executive levels. Analysis of workforce data allowed projections of the impact of retirements and attrition on Customs major occupations and the identification of potential skills imbalances.

Strategic planning for succession management emphasized the need to recruit entry-level inspectors and agents, the implementation of a Management Development Program to develop future Customs managers, and a Candidate Development Program to provide a cadre of potential executives.

The journeyman level of inspectors and canine enforcement officers was raised to GS-11, and that of Customs aids to GS-7, thus recognizing the increased importance and complexity of their duties. This resulted in more than 3,000 promotion actions. Retirement seminars and one-on-one counseling sessions were provided to advise prospective retirees of their benefits and assist them in making informed retirement decisions.

Injury Reduction

Safety and injury reduction continued to be a priority within Customs. An aggressive injury reduction strategy was developed to include:

- identifying the trends and root causes of injuries, making corrective recommendations, and purchasing personal protective equipment;
- utilizing field safety and occupational health managers to perform additional job hazard analyses and assist managers with job hazard analyses;
- emphasizing a Return to Work Program for injured employees; and
- providing injury prevention education and awareness programs.

Treasury's Safety and Health Information Management System (SHIMS), a web-based tracking system for injuries and illnesses, was implemented. SHIMS provides invaluable safety-related statistics that permit analyses of trends and root causes of injuries. The system will also establish an electronic interface with the Department of Labor to speed the processing of Workers' Compensation claims.

Two hundred and twenty-one safety inspections were conducted. Risk management strategies were used to categorize the results of safety inspections and standardized reporting requirements were established to address corrections and systemic problems.

Safety training was provided to nearly 1,600 employees, including training to 821 employees on confined space entry and 606 supervisors in safety measures. In addition, a safety orientation program was established for new employees at the Customs Academy.

On-site outreach was provided to employees affected by September 11 through the leading of efforts to decontaminate asbestos-containing materials in New York, and training numerous employees at international mail facilities and mail rooms on the use of personal protective equipment to shield against exposure to anthrax.

Employee Support

Customs employees continue to be its greatest resource. With additional hiring this year, several initiatives provided improved tools and information for employees. A CD-ROM, "New Employee Orientation," was developed to provide new employees with information about Customs and what is expected for their first day of work. The CD guides them on the preparation of their entry-on-duty forms. In addition, a new orientation program was established to provide employees attending basic classes at FLETC with an on-site human resources orientation to Customs.

HRM's Intranet site was expanded to provide a wide range of career resource information to assist employees in learning about job openings and promotional opportunities, including the Customs CareerFinder on-line application system. The Intranet site also includes extensive information on such topics as the new government long-term care insurance program, health and life insurance benefits; retirement benefits; pay and leave; and safety and wellness.

As a result of the elimination of printing and filing the notification of personnel actions, employees were offered

additional ways to obtain their employee transcripts through email and a mainframe requesting system. Customs made additional improvements to Pathfinder, an employee self-service system used to obtain vacancy announcements, benefits information, and projected retirement annuities.

EQUAL EMPLOYMENT OPPORTUNITY

During FY 2002, the Office of the Special Assistant to the Commissioner for Equal Employment Opportunity (EEO) continued to strengthen accountability throughout the organization while improving the efficiency and effectiveness of the EEO program.

Complaints Management

In order to enhance the EEO counseling process, the EEO Office appointed a cadre of full-time EEO Specialists to provide EEO counseling services to the workforce. With the expertise of fully committed and trained practitioners, who focused on conflict resolution and directing non-EEO claims to alternate forums, Customs realized a reduction of formal complaints filed for the fiscal year.

Recruitment of People with Disabilities

EEO implemented a Recruitment Plan for Persons with Disabilities to comply with Executive Order 13164. Throughout the year, Customs participated in career fairs to recruit qualified applicants with disabilities for targeted positions. Through the efforts of organizations within Customs, 76 persons with disabilities were hired this fiscal year; this number exceeded Customs annual goal by one.

World Class Training Initiative

During FY 2002, EEO, in partnership with the Office of Training and Development (OTD), developed the framework for a world class training initiative which will premiere in FY 2003, using the Intranet as the basis for mandatory training. Mandatory training will include modules on Effective Management and EEO issues and dispute resolution for Customs senior executives, managers and supervisors, employees, and EEO practitioners, including Customs mediators. This training initiative will feature a resource warehouse on the Customs Intranet to provide all employees access to EEO federal regulations and links to other government agencies responsible for the enforcement of civil rights laws. There will also be an online inventory of EEO cases, annual EEO reports, and directives available to employees on the Intranet in FY 2003.



Good communication helps to maintain employee morale.

Workforce Diversity Trends

The table below provides a 3-year comparison of the diversity of the Customs workforce. Overall, the population of each minority group has increased from FY 2000 totals.

Workforce Diversity Trends							
	FY2000	FY 2001	# Change FY 00 to FY 01	% Change FY 00 to FY 01	FY 2002	# Change FY 01 to FY 02	% Change FY 01 to FY 02
Female.White	3832	3,806	-26	-0.68%	3,962	156	4.10%
Female.Black	1328	1,327	-1	-0.08%	1,369	42	3.17%
Female.Hispanic	1095	1,135	40	3.65%	1,199	64	5.64%
Female.Asian American	310	321	11	3.55%	329	8	2.49%
Female.Native American	37	39	2	5.41%	36	-3	-7.69%
Female.Non-Hispanic in PR	7	4	-3	-42.86%	6	2	50.00%
Female.Total	6609	6,632	23	0.35%	6,901	269	4.06%
Male.White	8576	8,759	183	2.13%	9,446	687	7.84%
Male.Black	827	850	23	2.78%	853	3	0.35%
Male.Hispanic	2473	2,638	165	6.67%	2,864	226	8.57%
Male.Asian American	474	488	14	2.95%	545	57	11.68%
Male.Native American	94	97	3	3.19%	104	7	7.22%
Male.Non-Hispanic in PR	37	32	-5	-13.51%	41	9	28.13%
Male.Total	12481	12,864	383	3.07%	13,853	989	7.69%
Grand Total	19,090	19,496	406	2.13%	20,754	1,258	6.45%

TRAINING

In its third year of existence, OTD continued to set records by every measure: it increased Customs training to over 160,000 instances in FY 2002, up from 104,000 in FY 2001; rapidly shifted (after September 11) its top training priority to develop and enhance dozens of courses in anti-terrorism; and completed development of numerous new courses based on strict business case methodology with more courses underway. Its anti-terrorism training was recognized as being groundbreaking by several other law enforcement agencies, and its planning systems were recognized and adopted by other agencies. OTD was asked to present its award-winning National Training Plan at OPM's President's Management Agenda Conference, the National Training Officers' Conference, and the Federal Law Enforcement Accreditation Task Force Conference.

Strategic Challenges/Goals/Objectives

Implement a National Training Plan emphasizing anti-terrorism and making strategic use of training to meet Customs performance goals.

The National Training Plan (NTP) is Customs annual plan for training, representing its national priorities, goals, and planned investments for the workforce. Immediately following September 11, the NTP was analyzed to determine the most critical training in light of Customs number one priority, combating terrorism. Prior to publication, and throughout the year, the plan was adjusted to reflect this priority. The NTP process allowed Customs to conduct a timely and strategic response to address the vast number of new training needs.

Accordingly, OTD mobilized all training resources to align with Customs strategic mission shift, developed and delivered a new anti-terrorism curriculum agencywide, and trained four times the number of agent and inspector recruits as in a typical year. Customs established an Anti-Terrorism Tiger Team to speed development of training, work with all



Firearms instructors oversee the firing line.

Customs training providers and customers to identify needs, share information, and eliminate duplication. Customs training staff conducted an extensive survey of other agency/private sector anti-terrorism training and developed a database to evaluate, share, and track anti-terrorism course information.

OTD designed and delivered an anti-terrorism video viewed by all inspectors and canine enforcement officers and recognized as outstanding by internal and external organizations. Customs developed mandatory anti-terrorism training for inspectors and CSI training for field operations targeters and supervisors. Working in partnership with the Office of Anti-Terrorism, OTD developed Customs first joint training through tabletop exercises dealing with crisis scenarios at high-risk ports of entry. Customs also coordinated delivery of several specialized programs, including the Department of Energy Radiation Academy training. Intelligence training was strengthened and needs assessments for investigations and intelligence personnel were conducted to identify in-depth training requirements in anti-terrorism. In addition to delivering new courses, the Customs Academy played a critical role by shifting to a mandatory six-day training week and increasing anti-terrorism training in basic, advanced, and specialized courses. The Academy graduated 5,822 students in FY 2002, an increase of 1,199 graduates over FY 2001, which was the previous record capacity training year.

Administer to the tactical competency of Customs armed officers in support of enhanced border and homeland security responsibilities.

Customs issued a new Use of Force (UOF) policy for its 13,000 armed employees and created lesson plans/job aids to inform armed officers of policy changes. OTD instituted a process to review UOF critical incidents for training

implications and provided timely officer safety information through bulletins/notices. OTD procured and issued multi-purpose firearm lock boxes to all armed officers to reduce thefts and increase officer safety.

In addition to training an increased number of firearms and defensive tactics instructors this year, Customs also trained hundreds of National Guard personnel to support border operations as well as instructors in firearms and tactics.

Customs managed the design of an advanced firearms and tactics training facility in Harpers Ferry, WV. Customs procured land to increase access and safety, and awarded the contract for construction. This new facility is designed to support the dynamic requirements of Customs armed officers as their roles and responsibilities expand in border security.

Establish technology-enabled distance learning systems that will deliver training on site and on demand to reach a widely dispersed and diverse workforce.

Customs e-Learning initiative was expanded to supervisors and managers to support a Continuing Management Education initiative. The new Customs Education and Training Network was launched to fulfill the need for a vast communication and broadcast capability. The satellite broadcast system includes 350 downlink sites capable of broadcasting law enforcement training 24 hours per day, 5 days per week. Several CD-ROMs were produced, including the Award Winning Customs Orientation CD *Working Together as a Team*, *New Employees Orientation Kit*, and *Personal Search Handbook Update*. In addition to CD-ROMs, new videos and web-enabled courses were developed. Customs won two International awards, the Absolute Excellence in Electronic Media and the Excellence in Government for interactive development and interface design.

OTD's distance learning team established partnerships and collaborated with internal training providers, professional associations, academia, law enforcement entities, and other government agencies to maximize use of financial, material, and personnel resources. In partnership with FLETC, a Learning Management System is being developed which designs and tracks individual training and shares courseware across agencies. The Defense Criminal Investigation Organization, in partnership with the Central Intelligence

Agency and Customs, shares products and experiences concerning law enforcement training and intelligence training.

In response to the President's Management Agenda, strengthen the core leadership curriculum and design accelerated programs to meet succession management needs.

Customs reviewed the core curriculum for supervisors and managers to ensure that programs are delivering quality training to meet leadership needs. A new team leader course was designed, supervisory training is being recast to meet workforce effectiveness goals, and e-Learning programs are being added to permit continuous learning at worksites. A new Mentoring Guide was issued, desk references for supervisors and managers were updated, and anti-terrorism modules are being added to the curriculum. Customs graduated its second Customs Leadership Institute class and completed a long-term evaluation study to demonstrate its value to Customs.

OTD partnered with HRM to develop programs to meet succession management needs for first line supervisors seeking management positions and to prepare managers for executive positions. Training and development activities for these future managers and executives is closely aligned to the target positions so that qualified persons will be prepared to assume greater responsibilities immediately upon placement into higher level positions.

FINANCIAL MANAGEMENT

Overview

Customs strives to be a leader in financial management by providing high quality, cost-efficient financial management services through customer involvement and modern, integrated financial systems. Our goal is to develop and promote more effective and efficient methods to obtain and manage financial data, resources, and capital assets, consistent with the needs of customers and stakeholders.

Critical in this process is the responsibility to safeguard and properly account for revenue—accurately identifying amounts owed the U.S. Government under existing laws and regulations; efficiently and effectively making collections; and accurately reporting the status of revenue. Equally

important is the requirement to acquire and effectively manage the assets needed to accomplish Customs frontline mission. This includes: translating workloads and requirements into budget requests for needed resources; allocating and distributing funds after resources are made available; acquiring and distributing personnel, goods, and services that are used to accomplish Customs mission; managing and paying for those goods and services; and, reporting on the costs and use of personnel, goods, and services.

Challenges/Strategies

One major new challenge facing Customs financial operations in FY 2002 was the impact of the terrorist attacks on the United States on September 11, 2001. As a result of the tragic events of September 11 and the total loss of the New York Customshouse at 6 World Trade Center, Customs had to deal with the problem of re-establishing operations in New York. This included the tasks of finding new working space, equipment, and supplies for over 760 Customs employees, and planning for continuity of operations for a port that processes almost a fifth of all entries nationwide. Additionally, the task of planning for the future, in light of major new priorities associated with combating terrorism, involves obtaining and putting into place the resources for fighting this new war.

Customs also faces a number of continuing challenges in the financial arena. One is to improve its systems capabilities for accounting and reporting of financial information to meet the high standards now expected of Federal Government entities. This will entail a more effective use of financial information in conjunction with budget and cost information to help managers make better decisions. In May 2002, we began this process by preparing summary financial reports to assist senior management in making informed decisions. In addition, Customs will need to use technology and advances in information management to improve financial management services to customers and stakeholders. The explosive growth of U.S. trade with other countries, as stimulated by international trade agreements, will continue to increase the challenges associated with collecting and accounting for correct amounts of revenues due to the United States.

Strategies to address these challenges involve efforts to modernize and improve our technology, systems, and

processes. We continue to pursue the enhancement of existing systems and the development of new systems and procedures that maximize the use of electronic commerce in accomplishing financial transactions. We also have placed greater emphasis on the training and revamping of our workforce to accompany anticipated changes in technology and equipment. We have made real progress in developing a fully integrated, automated system to process financial accounting, procurement, and asset oversight transactions to ensure the reliability, accuracy, and usefulness of our financial system data and to simplify the burden of data entry and retrieval. We anticipate that the improvement of our financial systems will parallel the modernization of Customs commercial systems to ensure effective coordination and synchronization of system functions.

FY 2002 Initiatives

In FY 2002, Customs made progress in implementing a number of major financial management initiatives.

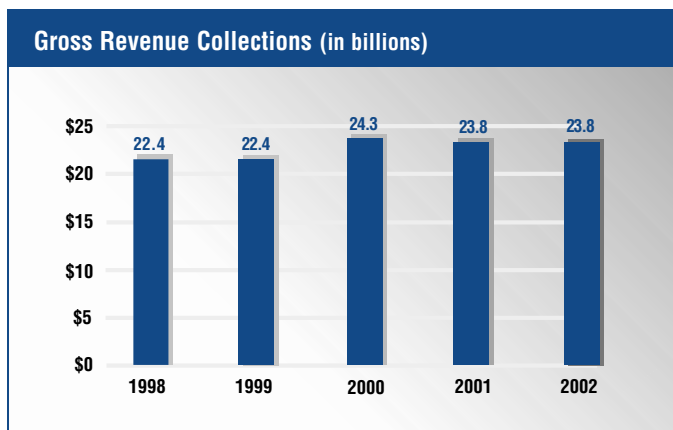
Some of the more significant were:

- Securing additional funding to address the costs associated with the recovery from the September 11 terrorist attacks and to fund new anti-terrorism mission priorities—\$622 million in new funding for FY 2002 and FY 2003;
- Relocating all of the New York employees who were previously housed at 6 World Trade Center within 3 days of the attack (we also are striving to accelerate the construction and build-out phases of renovations in six separate facilities required to house the displaced workers);
- Securing \$300 million in appropriations for the continued development of ACE;
- Developing and implementing SAP/R3 (integrated financial management software) as part of efforts to modernize Customs financial systems (we implemented Release 1, Real Property Management; continued to develop Release 2, Personal Property Management; and the Procurement automation aspect of SAP/R3);
- Improving customer service by continuing to make strides in E-Commerce with: electronic transmission of IRS Form 1099 and W-2; implementation of a Central Contractor Registration (CCR) system; and the establishment of a Customswide, internet-based Uniform Program;
- Increasing our use of electronic commerce in vendor payments, travel, and salary payments; and increasing the number of credit customers paying electronically, collecting \$572 million in FY 2002;
- Establishing a new approach to improve acquisition planning and justification for all non-information technology (non-IT) resources, using a Non-IT Capital Assets Review Board and business case analysis review process;
- Exceeding Treasury's challenge to submit monthly financial data within 3 days following the end of each month (we accomplished this requirement 2 months prior to Treasury's established deadline);
- Processing 100 percent of 192 court-ordered Harbor Maintenance Tax (HMT) refund requests totaling \$99.5 million and issuing 171 refunds amounting to \$145.7 million, of which \$47 million was interest (in addition, we processed 1,615 Administrative HMT refund requests totaling \$163 million);
- Implementing provisions of the Continued Dumping and Subsidy Offset (Byrd) Act of 2000 by processing more than 900 claims within the statutory timeframes, totaling over \$231 million;
- Installing the new modern Electronic Collection System at seven ports of entry in FY 2002 (a total of 42 ports have now received these new systems);
- Initiating a multi-office task force review of Customs user fees, recommending comprehensive revisions of the Consolidated Omnibus Budget Reconciliation Act (COBRA) user fee legislation, and proposing a new user fee structure, in order to recover the full cost of services provided by Customs;

- Implementing a budget process to adequately maintain the ports of entry identified in the infrastructure review of the 197 Northern and Southern Border port facilities; and coordinating a \$5 million facility funding plan to enhance Customs facilities; and
- Directing the design, construction, and operation of the Harper's Ferry Advanced Training Center, a \$20.5 million construction contract.

Financial Results and Performance Measures

Customs administers the U.S. Trade Program by enforcing the laws governing the flow of merchandise or commerce across U.S. borders, and assessing and collecting duties, excise taxes, fees, and penalties on imported and exported goods and services. In FY 2002, Customs collected \$23.8 billion in gross revenue; \$22.5 billion of this represented custodial revenue of which \$20.9 billion was returned to Treasury to fund other federal agency programs. Customs also returned \$36 million to the Governments of Puerto Rico and the U.S. Virgin Islands, transferred \$87.5 million to other federal agencies, used \$1.5 billion to fund refund and drawback payments for trade activity, and retained \$49 million to offset various program costs allowed by law and regulation.

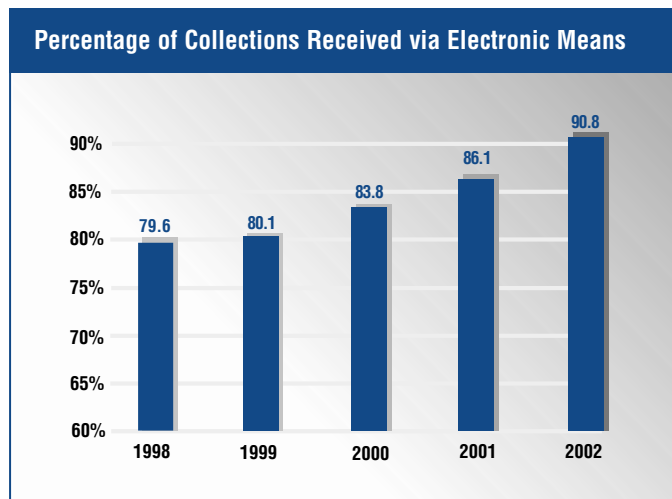


Goal: Increase total revenue collections through electronic means to at least 85 percent.

Measured Results: Customs revenue collections through electronic means reached 90.8 percent.

The accompanying chart depicts the dollar amount of collections received via electronic means as a percentage of

total collections. Customs collected \$23.8 billion in FY 2002 in tariff duty, user fees, Internal Revenue Service (IRS) excise taxes, and other assessments. In an effort to improve efficiency and reduce associated costs of the collection/deposit process, Customs has encouraged the trade community and other government agencies to use electronic means when making payments or transfers. Electronic payments made to Customs are credited to Treasury accounts faster than cash and checks. Much of the manual process associated with cash and check processing does not occur when funds are received electronically. Customs uses several different electronic transfer systems. The Automated ClearingHouse (ACH) is used to transfer payments from the trade community directly to Customs. The On-Line Payment and Collection System is an electronic system used by governmental agencies and bureaus to transfer funds within the government. Fedwire is used primarily to receive payments of IRS excise taxes and credit card transactions. The total amount of collections received via electronic means during FY 2002 was approximately \$21.6 billion, \$19.6 billion of which was via ACH.

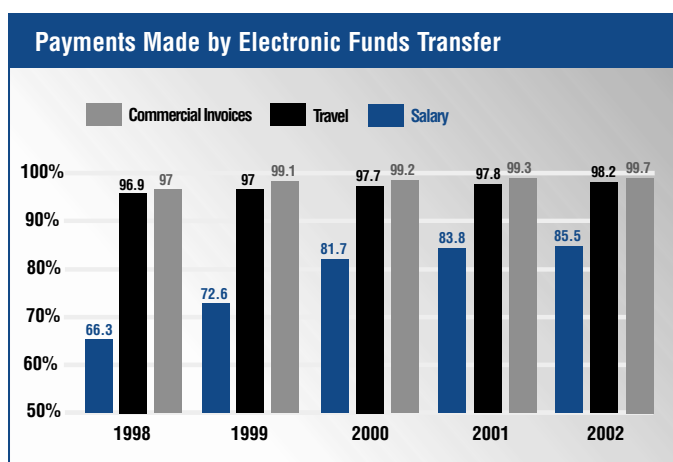


Goal: Increase the percentage of payments made through electronic funds transfers (EFT). At least 90 percent of commercial invoice payments, 95 percent of travel payments, and 98 percent of salary payments should be made by EFT.

Measured Results: The goals for travel and salary payments were exceeded, with 98.2 percent of travel payments and 99.7 percent of biweekly salary payments made by EFT. In August 2002, we increased the goal for commercial invoices paid via EFT from 80 to 90 percent to agree with the new

performance measure established by Treasury. In FY 2002 we reached 85.5 percent.

The accompanying chart identifies an incremental increase from FY 2001 to FY 2002 in the payments made by EFT. Public Law 104-134, the Debt Collection Improvement Act of 1996, requires federal payments to be made electronically, however, it also allows for certain exceptions under which the electronic requirement can be waived. Efforts will continue to further incremental increases in payments made electronically, but reaching a 100 percent payment rate is unlikely. Any additional increases in the number of EFT payments issued by Customs will still result in increased efficiencies in processing time and reductions in associated costs.



INFORMATION TECHNOLOGY

Introduction

The U.S. Customs Office of Information and Technology (OIT) provides integrated, comprehensive technical support to Customs mission. OIT provides information technology, research and development, scientific and forensic laboratory services, and manages the Customs Modernization program. OIT also manages Customs computer security program; establishes automated interfaces between Customs and trade participants, and other government agencies; and provides reference library and electronic information resources.

Strategic Challenges and Goals/Objectives

OIT is focused on providing innovative technology solutions to support Customs dual role as both the primary protector of the nation's borders against terrorists and others who would attempt to transport illegal or dangerous materials into the country, and as the facilitator of legal trade through our ports of entry, ensuring the continued collection of revenues for the government of the United States.

Customs Modernization

To achieve Customs strategic goals, the Customs Modernization Program began developing ACE, which will replace the current trade import system. ACE will provide an integrated, fully automated information system to enable the efficient collection, processing, and analysis of commercial import and export data. The improved information technology will multiply the impact of Customs personnel by helping them work both more efficiently and effectively. ACE will expedite the legal flow of goods so that legitimate trade can move more easily across the borders, while allowing Customs to focus more resources toward enforcement, anti-terrorism, and other illegal activities.

ACE and other modernization initiatives will empower the guardians of our nation's frontline by providing them with the best information and the best technology to protect citizens from security, health, and safety risks, sustain the vitality of our economy, and maximize the use of Customs resources.

Technology Support for the Commissioner's Programs

Beginning in February 2002, OIT personnel undertook the design and installation of networks for use by Customs inspectors and agents at several of the foreign cargo port sites indicated in Commissioner Bonner's CSI initiative. These networks will operate as critical links in the technology used to prescreen high-risk containers. To date, OIT personnel have successfully installed networks at three sites in Canada — Halifax, Montreal, and Vancouver — as well as three separate locations in Rotterdam, The Netherlands. They have begun work to set up networks in Le Havre, France, and have conducted site surveys of port locations in Antwerp, Belgium, as well as Hamburg and Bremerhaven, Germany. OIT will continue to support CSI in 2003 with the design and installation of networks for use at 20 or more additional CSI sites around the world.

Accomplishments and Highlights

OIT accomplished several key milestones this year.

OIT established a commercial disaster recovery facility to support the Customs National Data Center. This facility provides essential computing services to Customs should a catastrophic incident impact the National Data Center. This facility addresses numerous Office of Inspector General (OIG) and General Accounting Office (GAO) audit findings.

- The Trade Support Network (TSN) was revitalized in 2001 by Customs to provide a forum for the discussion of significant redesign efforts for the new import system, ACE. There are over 120 members of the TSN who represent the entire breadth of the trade community, including trade associations, importers, brokers, carriers, sureties, and others as well as Customs. To date, the TSN has submitted over 100 user requirements. All but two have been accepted by Customs and will be used in the development of ACE. The TSN ensures that ACE will meet the needs of the business community, as well as the needs of participating government agencies.
- In 2002, the Customs Modernization Program accomplished a major milestone in the ACE program by initiating development of the first ACE increment. Once deployed, the first increment will have an immediate effect on the way Customs does business by eliminating paper-based entry by entry filing and moving to an internet account-based periodic filing environment. The first increment of ACE will also increase trade efficiency by providing for the expedited release of truck shipments to highly compliant importer accounts.
- C-TPAT participants are now able to receive expedited electronic filing of their import entries due to the creation of a database in ACS that identifies entries from commercial participants at the time of filing. C-TPAT entries are expedited through the electronic filing and release process as a result of program participants having established secure procedures along their entire supply chain.

- OIT developed and implemented an Internet E-mail interface for submission of airline passenger manifests that now processes 3,000 manifest submissions daily, and has been instrumental in achieving a higher degree of industry compliance with the Aviation Security Act. Inspectors now have passenger information prior to the arrival of flights and can process international travelers more efficiently.

In addition to these major accomplishments, OIT:

- Strengthened our radiation detection capabilities at the border by deploying more than 5,100 Personal Radiation Detectors (PRDs) with an additional 4,000 more on order. The PRDs are worn on an inspector's belt and continually screen the environment for above-background radiation readings. During the next year, we will continue to build our radiation capabilities by deploying Radiation Isotope Identification Devices which actually identify the radiation source and deploying portal radiation monitors which are sensitive to gamma and neutron radiation emitted by radioactive material. The portal radiation monitors will be installed initially at mail and express consignment facilities and at major Northern Border crossings. Subsequent deployments will be made to major seaports, Southwest Border crossings, air cargo facilities, and all other points of entry.
- Provided essential laboratory and forensic support to Customs to identify and interdict transshipped Chinese garlic and steel products, counterfeit pharmaceuticals, and other harmful agricultural products.
- Launched the newly redesigned Customs Intranet (Customsnet) in July 2002. Customsnet provides a powerful agencywide communication tool at the desktop to disseminate important information to Customs employees.
- Provided Customs employees with desktop access to the complete holdings of the Information Resource Center and over 5,000 publications and nearly 200 newspapers. This state-of-the-art integrated, virtual library system allows Customs employees to research at their workstations more than 100,000 items housed in the Information Resource Center.

- Received recognition of our continued efforts to improve overall management of our resources from the Treasury Chief Information Officer (CIO) Council, who selected Customs Investment Management Process for selecting Information Technology investments as a “Best Practice” by the Treasury CIO Council. In addition, GAO recognized Customs as a model agency for Enterprise Architecture Management by selecting Customs as the only federal agency to achieve the highest rating under the GAO’s Enterprise Architecture Framework.
- Received recognition from the Potomac Forum, a non-profit educational organization, for the Information Systems Security Program. They acknowledged Customs program as a “Civilian Government Best Business Practice” that demonstrated leadership in the information assurance area. Information assurance is a global term that defines the management of protecting and defending information and information systems by ensuring their availability, integrity, authentication, confidentiality, and nonrepudiation. This includes providing for restoration of information systems by incorporating protection, detection, and reaction capabilities.
- Exceeded Department of the Treasury small business goals for small business contracting in the information technology area and received the Small Business Program Innovation Award for innovative executive level support for Customs Small Business Program.



Customs labs are among the best in the world.

Annual Assurance Statement for FY 2002

Due to current deficiencies in the quality and adequacy of data provided by Customs financial accounting and reporting systems, I cannot provide reasonable assurance that Customs overall controls and financial management systems are in conformance with standards prescribed by the Comptroller General of the United States. Based on the current status of previously identified deficiencies in our core financial systems, we do not have reasonable assurance that the objectives of Section 4 of the FMFIA have been achieved, namely the conformance of our fiscal and administrative systems to General Accounting Office principles and standards. Customs financial management systems are not currently in compliance with Federal financial management systems requirements, applicable Federal accounting standards, or the United States Government Standard General Ledger at the transaction level. As a consequence, Customs is also not in compliance with the requirements of the Federal Financial Management Improvement Act. However, with the exception of the material weaknesses described in the attachments, I can state compliance with the control objectives of Section 2 of the FMFIA. I can also state that, with the exceptions noted in our report, our continuity of operations planning in critical areas is adequate to reduce risk to reasonable levels and that our controls are sufficient to minimize any improper or erroneous payments. With regard to Customs performance data information, I can state with reasonable assurance that the measures reported as part of our performance plan are reliable and accurate.

Federal Managers' Financial Integrity Act (FMFIA) Summary

Customs has evaluated its management controls and financial management systems for the fiscal year ending September 30, 2002, as required by the FMFIA of 1982. This report is based partially upon our self-evaluation process. However, I note that the number and scope of our internal controls reviews for FY 2002 (e.g., the suspension of trade compliance measurement for national security reasons following September 11) were diminished by the events of September 11, and our subsequent emphasis on new priorities. Customs also relied upon audits conducted during the year by the Office of Inspector General and the General Accounting Office in its assessment process.

Customs continues to support the objectives of FMFIA and the Federal Financial Management Improvement Act (FFMIA) in promoting greater accountability throughout government. Effective internal controls have been a priority at Customs over the last several years. Of the 115 internal control weaknesses identified under Section 2 since inception of the program and previously reported, 113 have been corrected and closed. There were only two unresolved weaknesses at the beginning of FY 2002. Based on the progress we have made in addressing our weaknesses this year, we have been able to downgrade one of these two from a material weakness to a reportable condition. Of the 35 accounting systems non-conformances identified since the beginning of the program and reported by FY 2002, one remained unresolved at the beginning of FY 2002. This relates to deficiencies in our core financial systems. The solution for this weakness involves installation of complex, automated systems or significant modification of existing systems. We have made significant progress this year in planning and beginning the implementation of systems changes that will address the materiality of this weakness. Appropriated funds were received in FY 2001 and FY 2002 for implementation of the Automated Commercial Environment project and we have also established funding for purchase and use of SAP software up through Phase II of the SAP project. The receipt of funding means that systems solutions that have been contemplated for years now appear feasible within reasonable timeframes.

The review of Customs internal controls conducted in FY 2002 by an external auditor, KPMG, has resulted in four material findings. One of these is simply a reiteration of our core systems financial weakness discussed above. As a result of the other three material findings, we are reporting three new material weaknesses. Please note, however, that one of the three new material weaknesses has already been corrected.

This weakness resulted from the suspension of Customs Trade Compliance Measurement Program after the events of September 11, which was done to devote resources to responding to the continuing terrorist threat. The KPMG auditors found that, as a result of this suspension, Customs lacked a statistically valid measurement of the effectiveness of its system of controls over the entry process for FY 2002. The Trade Compliance Measurement process was, however, reinstated in September 2002 before KPMG issued its findings. The other two new material weaknesses involve deficiencies in controls to prevent excessive drawback claims and the need for improvement in system logical access and software maintenance controls. A description of the new material weaknesses is provided in Section I of our report.

To elaborate upon the assurance statement presented above, I note that Customs has in place systems of management control which are designed to ensure that:

- a) programs achieve their intended results;
- b) resources are used consistent with our overall mission;
- c) programs and resources are free from waste, fraud, and mismanagement;
- d) laws and regulations are followed;
- e) continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels;
- f) controls are sufficient to minimize any improper or erroneous payments; and
- g) performance information is reliable.

Based on information provided to me by the Office of Finance, I cannot provide reasonable assurance that these objectives have been met in the procurement area. Although I am not aware of any instances where these objectives have not been met in the procurement area, this is an area where Customs should strive to improve processes, oversight by senior managers, and other controls. To this end, and on the recommendation of the Office of Finance, I have authorized the hiring of a Chief Procurement Officer.

With the exception of improvements that need to be made in our continuity of operations planning, specifically in areas relating to transitioning to an alternate facility in the event of an emergency, I can provide reasonable assurance that our continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels.

With regard to the remaining objectives identified above, our management control systems, as a whole, provide reasonable assurance that these objectives were achieved during FY 2002, with the exceptions of statements made above and the material weaknesses and reportable conditions described below in Sections I and III.

As demonstrated by the number of weaknesses reported and closed since we have been reporting under FMFIA, Customs has made significant progress in addressing and resolving management controls issues.

SECTION 1: OPEN MATERIAL WEAKNESSES

Attachment A

AS OF SEPTEMBER 30, 2002

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Major Milestones a) Short Term b) Long Term	Milestone Dates	
					Original Due Dates	Current Due Dates
4A	CS-93-01	Financial Systems	Customs financial systems do not provide complete and accurate information for financial reporting and for preparation of audited financial statements.	a) Short Term		
				1. Negotiated initial three tasks of the Modernization Prime Contract.	10/30/01	✓10/30/01
				2. Implemented Phase 1 of the software deployment of the SAP/R3 software package.	10/01/01	✓4/08/02
				3. For the ACE development project, deliver a System Requirements Document update.	7/23/02	✓8/29/02
				4. Deliver ACE Increment 2 Requirements Specification Set.	9/16/02	✓10/11/02
				5. Deliver ACE Increment 2 Concept of Operations.	9/23/02	✓8/29/02
				6. Develop 40 managed accounts to participate in ACE (Increment 1, Release 1).	9/19/02	✓9/19/02
				7. Develop System/Subsystem Design Description (SSDD) for establishing accounts receivable subsidiary ledger for Increment 1, Release 2 (Task Order 8).	10/25/02	TBD
				8. Develop Subsystem Specifications (SSS) for initial interface of subsidiary ledger to general ledger, Increment 2 (Task Order 5).	3/1/03*	
				9. Deploy ACE portal for 40 managed accounts.	5/31/03*	
				10. Deploy accounts receivable subsidiary ledger, Increment 1, Release 2.	9/30/03*	
				b) Long Term		
				1. Implement Release 2 (Procurement and Asset Management and Core Financials to support ACE).	10/01/03	
				2. Initial interface of subsidiary ledger to the general ledger, Increment 2.	2/29/04*	
				3. Implement Release 3 (Remaining core financials) of the SAP/R3 software package.	10/01/04**	
* These dates assume an accelerated ACE development schedule for FY 2003. Since the FY 2003 President’s Budget does not provide funds for this, these dates are in question.					✓ = Completed	
** This date is contingent upon receipt of full funding for Release 3 of the SAP Implementation project.						

Section 2 = Overall Internal Controls, Section 4A = Administrative Systems, Section 4F = Fiscal Systems

SECTION 1: OPEN MATERIAL WEAKNESSES

Attachment A

AS OF SEPTEMBER 30, 2002

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Major Milestones a) Short Term b) Long Term	Milestone Dates	
					Original Due Dates	Current Due Dates
2	CS-94-02	Inability to timely restore critical systems; lack of a disaster recovery plan.	Deficiencies impair Customs ability to respond to a disruption in business operations.	a) Short Term 1. Conduct the Network Connectivity test at the CRF. This will finalize the testing of all components required for the recovery of all Customs Mission Critical Systems. 2. Establish an operational hot site capability at the CRF. 3. Conduct a general simulation test of the CRF backup functions. b) Long Term	9/21/02 9/30/02 11/30/02**	✓9/21/02 11/30/02

** All component tests were completed successfully, but Department is awaiting successful completion of integrated test that will be conducted mid-November. Successful integrated test should demonstrate to all resolution of this material weakness.

* Section 2 = Internal Control Material Weaknesses

Section 4A = Administrative Systems Material Non-conformances

Section 4F = Fiscal Systems Material Non-conformances

SECTION I: OPEN MATERIAL WEAKNESSES

Attachment A

AS OF SEPTEMBER 30, 2002:

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Major Milestones a) Short Term b) Long Term	Milestone Dates	
					Original Due Dates	Current Due Dates
2	CS-02-1	Controls Over the Entry Process	Due to the events of September 11, 2001, Customs suspended its Trade Compliance Measurement Program in FY 2002. The lack of statistical measurement hindered Customs ability to determine the extent of compliance with laws and regulations and to estimate the revenue gap.	a) Short term Re-establish the Trade Compliance Measurement Program with additional capabilities to assist enforcement efforts along with its previous ability to measure trade compliance. b) Long Term		✓9/30/02 ✓= Completed

* Section 2 = Internal Control Material Weaknesses

Section 4A = Administrative Systems Material Non-conformances

Section 4F = Fiscal Systems Material Non-conformances

SECTION I: OPEN MATERIAL WEAKNESSES

AS OF SEPTEMBER 30, 2002

Attachment A

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Major Milestones a) Short Term b) Long Term	Milestone Dates	
					Original Due Dates	Current Due Dates
2	CS-02-2	Controls Over Drawback Claims	Because Customs Automated Commercial System can not compare entry and export information electronically, Customs relies on a risk-based approach to review drawback claims. However, Customs risk-based selectivity process is not adequate to allow for adequate measurement and statistical projection of the results of the control process.	a) Short Term A plan with more detailed milestones will be formulated by the end of December 2002 to address this weakness. b) Long Term	12/31/02	

* Section 2 = Internal Control Material Weaknesses
 Section 4A = Administrative Systems Material Non-conformances
 Section 4F = Fiscal Systems Material Non-conformances

SECTION I: OPEN MATERIAL WEAKNESSES

AS OF SEPTEMBER 30, 2002

Attachment A

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Major Milestones a) Short Term b) Long Term	Milestone Dates	
					Original Due Dates	Current Due Dates
2	CS-02-3	Logical Access and Software Maintenance Security Controls	Network and host-based system configuration vulnerabilities exist that can potentially be used to compromise system security.	a) Short Term A plan with more detailed milestones will be formulated by the end of December 2002 to address this weakness. b) Long Term	12/31/02	

* Section 2 = Internal Control Material Weaknesses
 Section 4A = Administrative Systems Material Non-conformances
 Section 4F = Fiscal Systems Material Non-conformances

SECTION II: THE LIST OF MATERIAL WEAKNESSES REDUCED TO NON-MATERIAL STATUS DURING FY 2002

Attachment A

FMFIA Section* (2, 4A, or 4F)	Bureau and Control Number	Title of Material Weakness:	Description of Material Weakness:	Validation Process Used/ Results Achieved**	Date Closed
2	CS-95-01	Inappropriate access to certain ADP files, inadequate control of emergency change process, and inappropriate separation of duties.	Access capabilities and control mechanisms for critical applications and major support systems needed improvement.	New procedures and handbook have been provided for review along with completed risk assessments. Progress on the migration to a new change control tool has been sufficient to establish that the risks involved have diminished sufficiently to reduce this from a material to a reportable condition.	9/30/02

* Section 2 = Internal Control Material Weaknesses
 Section 4A = Administrative Systems Material Non-conformances
 Section 4F = Fiscal Systems Material Non-conformances

** Validation Process Used/Results Achieved: Indicate how you have determined that the desired results were accomplished, thereby eliminating the material weakness conditions.

SECTION III: OPEN REPORTABLE CONDITIONS/SECOND TIER* ISSUES

AS OF SEPTEMBER 30, 2002

Attachment A

Source	Title of Reportable Conditions/Second Tier Issues:	Description of Reportable Conditions/Second Tier Issues:	General Actions Being Taken	Remarks
OIG-01-045	Drawback	Drawback controls need to be strengthened. (This originally included an array of OIG findings from previous years, some of which have been addressed, and others which are still being dealt with.)	Customs has proposed the closing of some drawback units; has conducted and will continue to conduct training for Chiefs and Specialists; has revised its training manual for new employees; is finalizing changes in current Guidance to include policies regarding accelerated payment, drawback workstations, selected processing, compliance and penalties, and proof of export. Customs field drawback units are currently conducting reviews of liquidated claims for at least the first six months of the FY using questions adapted from the Self-Inspection process, new worksheets, and a specifically drawn sample. Independent testing of disbursements is being done by the Office of Finance.	As part of the contract review which it performed for Customs in FY 2002, KPMG had a finding which it considered material for the drawback selectivity process.
OIG-01-045	Compliance Measurement	Compliance measurement programs need to be comprehensively implemented to identify the revenue gap and assess trade law compliance.	Customs has implemented a number of compliance measurement programs (CMPs), including a major CMP for formal entries over \$2000. The OIG has recommended the development of additional CMPs; this depends upon technology and additional funding.	The development of additional CMPs has been slowed by the events of September 11 and the demands these made on staff and resources.
OIG-01-045	In-bond Shipments	Controls over in-bond shipments need to be strengthened.	A number of Air Automated Manifest System fixes have been completed. Customs Automated Forms Entry System was piloted at several locations. This system provides Customs more data and provides the data in a more timely manner. Self-inspection worksheets were being used at one time to verify that audits and exams are being done and results recorded. This was suspended in FY 2002. The draft In-Bond Handbook was sent to the field as guidance.	Further improvements to the In-Bond CMP (Tin Man II) must compete with other automated system projects. To date, it has been given a lower priority in the formal rating process.
OIG-02-109	Controls Over Sensitive Property	Controls over sensitive property such as computers, badges, and credentials needs to be improved.	Customs has agreed to several corrective actions and has developed an overall action plan for improving property management in Customs. Customs is conducting a 100 percent inventory of computers and other defined sensitive items (such as pagers, cell phones, and radar detectors) by the end of FY 2002; all data will be reviewed and verified. This will continue as an annual requirement. An ammunition inventory will also be verified on an annual basis.	Subsequent to the special inventories of computers at the end of FY 2001, an analysis of the related documentation showed that many computers identified as lost or stolen were excessed, transferred, or were destroyed on 9/11/01.

* "Reportable Conditions" refer to issues the external auditors have raised as "Reportable Conditions," but are not "material" in nature.

* "Secondary Issues" refer to the bureau self-identified issues (non-material weaknesses) that warrant the bureau's attention and/or that are deemed serious enough that the Department needs to be notified.

SECTION III: OPEN REPORTABLE CONDITIONS/SECOND TIER* ISSUES AS OF SEPTEMBER 30, 2002

Attachment A

Source	Title of Reportable Conditions/Second Tier Issues:	Description of Reportable Conditions/Second Tier Issues:	General Actions Being Taken	Remarks
OIG-02-020	Customs Processing of International Mail	Better controls, particularly in targeting of mail for inspection, could result in significant gains in revenue collection at Customs International Mail Branches.	Customs has been conducting a revenue gap survey to measure lost revenue on informal entries in the international mail. The USPS is working with Customs to provide accurate data on international parcels for this survey. Once the survey data are complete, Customs intends to change procedures to enhance targeting of dutiable mail and take corrective actions which have been identified as needed at individual International Mail Branches.	GAO has begun another independent review of this area which may have some bearing on final corrective actions taken.
Internal Review	Customs Badge and Credential Program	Existing procedures did not ensure the required level of accountability over badges and credentials and the inventory system was inadequate to accurately account for the number on hand.	Customs conducted a 100 percent review of badges/credentials and has successfully reconciled the inventory. A new and more comprehensive policy directive was issued. Customs conducted another annual inventory of badges and credentials in September 2002.	The OIG recommendations related to badges and credentials have been implemented. This finding will be removed from our list of reportable conditions in the future.

* "Reportable Conditions" refer to issues the external auditors have raised as "Reportable Conditions," but are not "material" in nature.

* "Secondary Issues" refer to the bureau self-identified issues (non-material weaknesses) that warrant the bureau's attention and/or that are deemed serious enough that the Department needs to be notified.



Customs

Fiscal Year 2002

Financial Statements



Department of the Treasury, United States Customs Service

Consolidated Balance Sheet

As of September 30, 2002 and 2001

(Dollars in Thousands)

Unaudited

	2002	2001
ASSETS (Note 2)		
Intra-governmental Assets		
Fund balance with Treasury (Note 3)	\$ 2,933,093	\$ 2,609,073
Accounts receivable (Note 5)	16,570	11,839
Receivable due from Treasury – refund and drawback (Note 5)	566,791	--
Advances and prepayments	20,635	22,765
Total Intra-governmental Assets	<u>3,537,089</u>	<u>2,643,677</u>
Cash and other monetary instruments (Note 4)	28,688	24,749
Accounts receivable, net (Note 5)	69,979	66,728
Duty and trade related receivables, net (Note 6)	1,171,043	900,852
Advances and prepayments	14,941	13,850
Inventory and related property (Note 7)	59,972	42,983
Property, plant and equipment, net (Note 8)	698,858	610,343
TOTAL ASSETS	<u>\$ 5,580,570</u>	<u>\$ 4,303,182</u>
LIABILITIES (Note 9)		
Intra-governmental Liabilities		
Accounts payable	\$ 57,490	\$ 50,529
Due to the General Fund	1,198,069	1,277,336
Employer benefits and taxes	7,489	17,732
Advances from others	9,756	13,800
Total Intra-governmental Liabilities	<u>1,272,804</u>	<u>1,359,397</u>
Accounts payable	155,304	114,371
Refunds payable (Note 10)	599,315	121,087
Advances from others (Note 10)	330,722	75,624
Payroll and benefits (Note 11)	157,039	200,368
Workers' compensation	275,455	271,621
Capital leases and software license agreements (Note 13)	101,567	118,872
Injured domestic industries (Note 14)	312,000	247,385
Other (Note 12)	20,245	17,496
TOTAL LIABILITIES	<u>3,224,451</u>	<u>2,526,221</u>
Commitment and contingencies (Note 15)		
NET POSITION (Note 16)		
Unexpended appropriations	1,362,926	856,645
Cumulative results of operations	993,193	920,316
TOTAL NET POSITION	<u>2,356,119</u>	<u>1,776,961</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 5,580,570</u>	<u>\$ 4,303,182</u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service

Consolidated Statement of Net Cost

For the Years Ended September 30, 2002 and 2001

(Dollars in Thousands)

Unaudited

	2002	2001
COSTS:		
Program: PASSENGER PROCESSING		
Intra-governmental gross costs	\$ 229,825	\$ 197,604
Less: Intra-governmental earned revenue	<u>(30,873)</u>	<u>(25,020)</u>
Intra-governmental net costs	198,952	172,584
Gross costs with the Public	600,320	529,024
Less: Earned revenues from the Public	<u>(21,773)</u>	<u>(21,199)</u>
Net costs with the Public	<u>578,547</u>	<u>507,825</u>
Net Program Costs	<u>777,499</u>	<u>680,409</u>
Program: TRADE COMPLIANCE		
Intra-governmental gross costs	318,220	283,996
Less: Intra-governmental earned revenue	<u>(42,308)</u>	<u>(35,959)</u>
Intra-governmental net costs	275,912	248,037
Gross costs with the Public	831,213	760,314
Less: Earned revenues from the Public	<u>(29,838)</u>	<u>(30,467)</u>
Net costs with the Public	<u>801,375</u>	<u>729,847</u>
Net Program Costs	<u>1,077,287</u>	<u>977,884</u>
Program: OUTBOUND		
Intra-governmental gross costs	26,518	27,294
Less: Intra-governmental earned revenue	<u>--</u>	<u>--</u>
Intra-governmental net costs	26,518	27,294
Gross costs with the Public	69,268	73,071
Less: Earned revenues from the Public	<u>--</u>	<u>--</u>
Net costs with the Public	<u>69,268</u>	<u>73,071</u>
Net Program Costs	<u>95,786</u>	<u>100,365</u>
Program: ENFORCEMENT		
Intra-governmental gross costs	309,380	264,611
Less: Intra-governmental earned revenue	<u>(41,164)</u>	<u>(33,505)</u>
Intra-governmental net costs	268,216	231,106
Gross costs with the Public	808,123	708,415
Less: Earned revenues from the Public	<u>(29,031)</u>	<u>(28,387)</u>
Net costs with the Public	<u>779,092</u>	<u>680,028</u>
Net Program Costs	<u>1,047,308</u>	<u>911,134</u>
NET COST OF OPERATIONS (Note 17)	<u>\$ 2,997,880</u>	<u>\$ 2,669,792</u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service
Consolidated Statement of Changes in Net Position
 For the Year Ended September 30, 2002
 (Dollars in Thousands)
 Unaudited

	2002
OPERATIONS	
Beginning Balances – 10/1/2001	\$ 920,316
Prior Period Adjustments	--
Beginning Balances, as Adjusted	<u>920,316</u>
Budgetary Financing Sources:	
Other adjustments	--
Appropriations used	1,686,565
Non-exchange revenue	1,236,693
Donations and Forfeitures of Cash/Equivalents	--
Transfers In/Out without Reimbursement	3,000
Other	(2,842)
Other Financing Sources	
Donations and Forfeitures of Property	2
Accrued Interest and Discount on the Debt	--
Transfers in/out without Reimbursement	10,260
Imputed Financing Sources	<u>137,079</u>
Total Financing Sources	3,070,757
Net Cost of Operations	(2,997,880)
NET POSITION FROM OPERATIONS	<u>\$ 993,193</u>
UNEXPENDED APPROPRIATIONS	
Beginning Balances – 10/1/2001	\$ 856,645
Prior Period Adjustments	--
Beginning Balance, as Adjusted	<u>856,645</u>
Budgetary Financing Sources:	
Appropriations Received	3,084,352
Appropriations Transferred in/out	77,951
Other Adjustments	(14,714)
Appropriations used	<u>(2,641,308)</u>
Subtotal – Total Financing Sources	506,281
NET POSITION OF UNEXPENDED APPROPRIATIONS	<u>\$ 1,362,926</u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service
Combined Statement of Budgetary Resources

For the Year Ended September 30, 2002
(Dollars in Thousands)
Unaudited

	2002
Budgetary Resources (Note 18)	
Budget authority	
Appropriations received	\$ 3,484,430
Net Transfers	34,081
Total Budget Authority	<u>3,518,511</u>
Unobligated Balance	
Beginning of period	1,052,321
Net transfers	46,870
Total Unobligated Balance	<u>1,099,191</u>
Spending authority from offsetting collections	
Earned	
Collected	494,902
Receivables from Federal Sources	5,974
Total Earned	<u>500,876</u>
Change in Unfilled Customer Orders	
Advance Received	(179)
Without advance from Federal Sources	20,691
Total Change in Unfilled Customer Orders	<u>20,512</u>
Transfers from Trust Funds	3,000
Total spending authority from offsetting collections	<u>524,388</u>
Adjustments	
Recoveries of prior year obligations	87,616
Permanently not available	(19,192)
Total Adjustments	<u>68,424</u>
Total Budgetary Resources	<u><u>\$ 5,210,514</u></u>
Status of Budgetary Resources	
Obligations Incurred	
Direct	\$ 3,529,027
Reimbursable	523,569
Total Obligations Incurred	<u>4,052,596</u>
Unobligated balance available	501,738
Unobligated balance not available	656,180
Total Status of Budgetary Resources	<u><u>\$ 5,210,514</u></u>
Relationship of Obligations to Outlays	
Obligated balance, net – beginning of period	\$ 739,855
Obligated balance, net – end of period	
Accounts Receivable	(34,875)
Unfilled Customer Orders from Federal Sources	(79,721)
Undelivered Orders	975,544
Accounts Payable	249,827
Outlays	
Disbursements	3,567,393
Collections	(497,723)
Net Outlays	<u><u>\$ 3,069,670</u></u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service

Consolidated Statement of Financing

For the Year Ended September 30, 2002

(Dollars in Thousands)

Unaudited

	2002
Budgetary Resources Obligated	
Obligations incurred	\$ 4,052,596
Less: Spending authority from offsetting collections and recoveries	612,006
Obligations net of offsetting collections and recoveries	3,440,590
Less: Offsetting Receipts	--
Net Obligations	3,440,590
Other Resources	
Donations and Forfeiture of Property	2
Transfers in/out without reimbursement	10,260
Imputed financing from costs absorbed by others	137,079
Net other resources used to finance activities	147,341
Total Resources Used to Finance Activities	3,587,931
Resources Used to Finance Items Not Part of the Net Cost of Operations	
Change in budgetary resources obligated for goods, services, and benefits	
Ordered but not yet provided	370,932
Resources that finance the acquisition of assets or liquidation of liabilities	157,921
Other resources or adjustments to net obligated resources that do not affect net cost of operations	79,002
Total resources used to finance items not part of the net cost of operations	607,855
Total Resources Used to Finance the Net Cost of Operations	2,980,076
Components Requiring or Generating Resources in Future Periods	
Increase in Annual Leave Liability	7,758
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	7,758
Components not Requiring or Generating Resources	
Depreciation and Amortization	93,836
Revaluation of Assets or Liabilities	(27,212)
Other	(56,578)
Total components of net cost of operations that will not require or generate resources	10,046
Total Components of net cost of operations that will not require or generate resources in the current period	17,804
Net Cost of Operations	<u>\$ 2,997,880</u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service

Statement of Custodial Activity

For the Years Ended September 30, 2002 and 2001

(Dollars in Thousands)

Unaudited

	2002	2001
SOURCES OF CUSTODIAL REVENUE AND COLLECTIONS		
Revenue Received:		
Duty	\$ 19,786,805	\$ 19,655,323
User fees	701,946	735,685
Excise taxes	2,025,968	1,803,479
Fines and penalties	57,699	66,867
Interest	15,493	56,154
Other	10,139	7,815
Total Revenue Received	<u>22,598,050</u>	<u>22,325,323</u>
Less: Refunds and other payments (Note 20)	<u>(1,489,753)</u>	<u>(932,304)</u>
Net Revenue Received	<u>21,108,297</u>	<u>21,393,019</u>
Accrual Adjustment	<u>(272,535)</u>	<u>(178,874)</u>
TOTAL CUSTODIAL REVENUE	<u>20,835,762</u>	<u>21,214,145</u>
DISPOSITION OF REVENUE RECEIPTS		
Amounts Transferred:		
Treasury General Fund Accounts	20,920,279	21,213,847
U.S. Department of Agriculture	70,036	67,552
Retained by U.S. Customs Service	48,975	49,660
Other Federal agencies	17,475	16,694
Government of Puerto Rico	33,635	39,555
Government of the U.S. Virgin Islands	2,405	5,711
Non-federal other	15,492	--
Accrual adjustment	<u>(272,535)</u>	<u>(178,874)</u>
TOTAL DISPOSITIONS OF REVENUE RECEIPTS	<u>20,835,762</u>	<u>21,214,145</u>
NET CUSTODIAL REVENUE ACTIVITY	<u>\$ 0</u>	<u>\$ 0</u>

The accompanying notes are an integral part of these statements.

Department of the Treasury, United States Customs Service

Notes to Financial Statements

Unaudited

1. Summary of Significant Accounting Policies**Reporting Entity**

The U.S. Customs Service (Customs), with headquarters in Washington, D.C., was created in 1789 and is a bureau of the U.S. Department of the Treasury (Treasury). Customs is primarily responsible for administering the U.S. Trade Program and U.S. Narcotics Enforcement Program. These responsibilities are met by: (1) enforcing the laws governing the flow of merchandise or commerce across the borders of the United States, (2) assessing and collecting duties, taxes, and fees, on imported and other goods and services, and (3) enforcing drug-related and other laws and regulations of the United States on behalf of Federal agencies and/or in conjunction with various state, local, and other Federal agencies and foreign countries.

Substantially all of the duty, tax and fee revenues collected by Customs are remitted to various General Fund accounts maintained by Treasury. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. Customs transfers the remaining revenue (generally less than two percent of revenues collected) directly to other Federal agencies, the Governments of Puerto Rico and the U.S. Virgin Islands, or retains funds as authorized by law or regulations. Refunds of revenues collected from import/export activity are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that Customs, as an agency of the Federal government, has been authorized by law to enforce.

Operating and other costs incurred resulting from the activities described above are funded principally through congressional appropriations on an annual, multi-year, and no-year basis. Accordingly, operating costs incurred are offset by appropriated funds that are recorded as financing sources or by reimbursable revenue, user fee revenue, or other financing sources. These operational activities are reflected in the entity accounts of Customs.

The Federal Account Symbols and Titles of Customs entity and non-entity accounts are presented in the Required Supplementary Information Section of this report.

Basis of Accounting and Presentation

The Government Management Reform Act of 1994 (GMRA) requires executive agencies, including Treasury, to produce audited financial statements for all its activities and funds. In previous years, including Fiscal Year 2000, the Director of the Office of Management and Budget (OMB) included Customs in their designation of agencies required to have financial audits performed as provided by GMRA. For Fiscal Years 2001 and 2002, OMB granted a request to remove Customs from the OMB required audit list. In place of an audit, the Treasury Office of Inspector General contracted with an independent public accounting firm to conduct a review of Customs Fiscal Year 2001 financial statements and complete agreed-upon procedures for the Fiscal Year 2002 financial statements.

These financial statements are provided to meet the requirements of the GMRA and have been prepared from Customs accounting records in conformity with generally accepted accounting principles (GAAP). GAAP for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which was designated the official accounting standard-setting body of the Federal Government by the American Institute of Certified Public Accountants. The statements consist of the consolidated balance sheet, the consolidated statement of net cost, the consolidated statement of changes in net position, the combined statement of budgetary resources, the consolidated statement of financing, and the statement of custodial activity, as prescribed by OMB Bulletin No. 01-09, which provides the statement form and content requirements. Due to formatting changes for the Fiscal Year 2002 statements of Net Position, Budgetary Resources, and Financing, we have not included Fiscal Year 2001 comparative data.

While these financial statements have been prepared in accordance with the formats prescribed by OMB, they are different from the financial reports used to monitor and control budgetary resources, which are also prepared from Customs accounting records.

These financial statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that payment of liabilities other than for contracts can be abrogated by the sovereign entity.

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Customs financial statements with respect to the consolidated balance sheet, the consolidated statement of net cost, and the consolidated statement of changes in net position are reported using the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred without regard to receipt or payment of cash. Customs combined statement of budgetary resources is reported using the budgetary basis of accounting. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. It generally differs from the accrual basis of accounting in that obligations are recognized when new orders are placed, contracts awarded, and services received, that will require payments during the same or future period. Customs statement of financing reconciles differences between the budgetary and accrual bases of accounting. Customs non-entity revenue and refunds are reported on the statement of custodial activity using a modified cash basis. With this method, revenue from cash collections are reported separately from receivable accruals, and cash disbursements are reported separately from payable accruals.

Assets and Liabilities

Intra-governmental assets and liabilities result from activity with other Federal agencies. All other assets and liabilities result from activity with parties outside the Federal government, such as domestic and foreign persons, organizations, or governments.

Fund Balance with Treasury

Entity fund balances with Treasury are the amounts remaining as of fiscal year-end from which Customs is authorized to make expenditures and pay liabilities resulting from operational activity, except as restricted by law. Non-entity fund balance with Treasury represents funds available to pay refunds and drawback claims of duties, taxes and fees; and, other non-entity amounts to be distributed to General Fund and other Federal accounts in a future period.

Cash and Other Monetary Instruments

Entity Cash represents imprest fund balances. Imprest fund balances remaining at September 30, 2002 relate to amounts available to support investigative operation activity. Undeposited collections represents monies to be distributed in a future period. A timing difference occurs when cash is received and applied to a specific revenue type in one period, and the deposit and distribution of funds occurs in a future period. Monetary instruments are held by Customs in lieu of an importer/broker filing a surety bond. Corresponding liabilities are recorded for amounts expected to be allocated in future periods to Federal agencies.

Accounts Receivable

Intra-governmental accounts receivable represent amounts due from Federal agencies. These receivables are expected to be fully collected. In fiscal year 2002, a portion of these receivables are based on a calculated estimate. The estimate is based on a ratio developed using historical accounts receivables and undelivered orders and applying the ratio to the undelivered orders at September 30, 2002. The receivable for fiscal year 2001 is based on a subsequent review of disbursements. Accounts receivable from reimbursable services and user fees represent amounts due from non-federal sources for services performed. These receivables are net of amounts deemed uncollectible which are determined by considering the debtor's current ability to pay, the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties, and an analysis of aged receivable activity. In fiscal year 2002, the user fee receivable is based on a calculated estimate. The estimate is based on historical user fee receivables. The receivable for fiscal year 2001 is based on a subsequent review of collections.

Duty and Trade Related Receivables

Accounts receivable consist of duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity which have been established as a legally enforceable claim and remain uncollected as of year-end. These receivables are net of amounts deemed uncollectible which were determined by considering the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties, and an analysis of aged receivable activity. Customs accounting policy for non-entity receivables is described in more detail in Note 6, Duty and Trade Related Receivables, Net.

Advances and Prepayments

Intra-governmental advances and prepayments consist of amounts paid to Federal agencies prior to Customs receipt of goods and services. All other advances and prepayments consist of employee travel and salary advances, prepaid rent, advances to grantees, and advances relating to certain investigative activities.

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Inventory and Related Property

Inventory consists of aircraft and marine parts and materials to be consumed in Customs operations. Aircraft parts and materials are recorded at average unit cost, and marine parts and materials are recorded using the First-In-First-Out valuation method. Both methods approximate actual acquisition costs. Disclosures are also made for seized property and currency resulting from enforcement activities. These items are not considered assets of Customs and are not reported as assets in Customs financial statements; however, Customs has a stewardship responsibility until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized. If forfeiture occurs, the seized property and currency become assets of the Treasury Forfeiture Fund, or in the case of prohibited items, such as counterfeit goods, narcotics, or firearms, are disposed of or destroyed by Customs. An annual analysis of change in Customs seized and forfeited property and currency activity are disclosed in Note 7, Inventory and Related Property.

Property, Plant and Equipment

Prior to October 1, 1995, Customs capitalized property, plant and equipment with an acquisition value of \$5,000 or greater, and a useful life of 2 years or greater. Beginning October 1, 1995, Customs capitalizes property, plant and equipment with an acquisition value of \$50,000 or greater, and a useful life of 2 years or greater. As of October 1, 2000, Customs implemented Statement of Federal Financial Accounting Standard (SFFAS) No. 10 – *Accounting for Internal Use Software*. SFFAS No. 10 requires the capitalization of all internal use software, including commercial off-the-shelf (COTS), contractor developed and internally developed software. As a result, Customs began capitalizing costs associated with the development of internal use software. In addition, Customs implemented the SFFAS No. 10 recommendation to apply capital lease accounting concepts to software license fee agreements that give Customs the “right to use” the software. Prior to October 1, 2000, costs relating to the development of internal use software and “right to use” license agreements were expensed. Customs also capitalizes bulk acquisitions of like-kind property, plant and equipment items that are individually valued under the capitalization threshold but are, in the aggregate, significant to Customs financial position or results of operations.

Expenditures for normal repairs and maintenance are charged to expense as incurred. Expenditures greater than \$50,000 for improving or rebuilding an asset and that increase an asset’s useful life are capitalized. Prior to October 1, 1995, expenditures greater than \$5,000 for improving or rebuilding an asset and that increased an asset’s useful life were capitalized.

Depreciation and amortization are computed using the straight line method over the estimated useful lives of the assets ranging from 5 to 20 years for equipment and software, 2 to 30 years for leasehold improvements, and 30 years for buildings and structures. Amortization of capitalized software begins on the date of acquisition if purchased or when the module or component has been successfully tested if contractor or internally developed.

Commercial/Travel Payable

A liability is recorded for an accounts payable accrual from commercial/travel activities. The fiscal year 2002 liability is determined using a calculated estimate. This estimate is based on a ratio developed using historical subsequent disbursements and undelivered orders and applying the ratio to the undelivered orders at September 30, 2002. Actual subsequent disbursements and a prior year estimate are the basis for the fiscal year 2001 accrual.

Awards and Foreign Expenses Payable

A liability is recorded for foreign language awards and expenses incurred by Customs Attaches at American Embassies worldwide. The fiscal year 2002 liability is based on an estimate developed using historical expenses. The fiscal year 2001 liability is based on a subsequent review of disbursements.

Other Non-Entity Items in Customs Custody

Customs has the authority, in accordance with provisions of the Federal Crime Code and Federal Rules of Criminal Procedures, to retain property within its custody for evidentiary purposes. Because this property is not seized under seizure and forfeiture laws, it cannot become property of the U.S. Government and is intended to be returned to the owner at some future date. This evidence is not disclosed in the financial statements or a related note as the amount is not significant, but does represent a fiduciary responsibility of Customs.

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Accrued Annual, Sick and Other Leave and Compensatory Time

Annual leave, compensatory time, and other leave time are accrued when earned. The accrual is presented as a component of the payroll and benefits liability in the balance sheet and is adjusted for changes in compensation rates and reduced for annual leave taken. Sick leave is not accrued when earned, but is expensed when taken.

Pension Costs, Other Retirement Benefits, and Other Post-employment Benefits

Most Customs employees hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS). Customs contributes 8.51 percent of base pay for regular employees, and 9.01 percent for law enforcement agents. Employees hired after December 31, 1983, are automatically covered by the Federal Employees' Retirement System (FERS) and Social Security. A primary feature of FERS is that it offers a savings plan to which Customs automatically contributes 1 percent of base pay and matches any employee contributions up to an additional 4 percent of base pay. For most employees hired after December 31, 1983, Customs also contributes the employee's matching share for Social Security. For the FERS basic benefit Customs contributes 10.7 percent of base pay for regular employees, and 23.3 percent for law enforcement agents. The pay base for determining Customs contributions to CSRS and FERS for inspectors and canine officers includes regular pay and up to a maximum of \$15,000 in certain overtime earnings for Fiscal Year 2002 and Fiscal Year 2001.

Customs recognizes the full costs of its employees' pension benefits; however, the liability associated with these costs is recognized by the Office of Personnel Management (OPM). As of September 30, 2002 and 2001, contributions of \$193.2 million and \$174.2 million, respectively, were made to these plans. In addition, Customs recorded an additional expense of \$53.1 million and \$52.1 million, as of September 30, 2002 and 2001, respectively, for employee pension benefit costs in excess of Customs contributions.

Similar to Federal retirement plans, OPM, rather than Customs, reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHBP) and the Federal Employees Group Life Insurance Program (FEGLI). Customs is required to report the full cost of providing other retirement benefits (ORB) for its retired employees as well as reporting contributions made for active employees. As of September 30, 2002 and 2001, Customs ORB expense for retired employees totaled \$61.7 million and \$51.9 million, respectively. As of September 30, 2002 and 2001, Customs contributions for active employees participating in the FEHBP and FEGLI programs were \$78.2 million and \$67.2 million, respectively.

An expense and liability for other post-employment benefits (OPEB), which includes all types of benefits to former or inactive (but not retired) employees, their beneficiaries, and covered dependents, is also recognized.

Workers' Compensation

A liability is recorded for estimated future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The FECA program is administered by the U.S. Department of Labor (Labor), which initially pays valid claims and subsequently seeks reimbursement from Federal agencies employing the claimants. Reimbursement to Labor on payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intra-governmental liability are made available to Customs as part of its annual appropriation from Congress in the year in which the reimbursement takes place.

Additionally, the actuarial liability estimate includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Based on information provided by Labor, Treasury allocates the actuarial liability to its bureaus and department offices based on the payment history for the bureaus and department offices. The net present value of estimated payments is not covered by budgetary resources and will require future funding.

Unexpended Appropriations

Unexpended appropriations represent the amount of Customs unexpended appropriated spending authority as of fiscal year-end that is unliquidated or is unobligated and has not lapsed, been rescinded or withdrawn.

Cumulative Results of Operations

Cumulative results of operations primarily represents the excess of user fee revenues over related expenses. It also reflects the net investment in property and equipment, and operating materials and supplies held for use, and transfers in of equipment, materials, and supplies from other Federal agencies without reimbursement. Also, included as a reduction in cumulative results of operations are liabilities

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incurred, which will require funding from future appropriations, such as accumulated annual and other leave earned but not taken, accrued workers' compensation, and contingent liabilities.

Revenue, Financing Sources and Expense Recognition

Customs entity activities are financed principally through appropriations, exchange revenue, and non-exchange revenue. Appropriations used are recognized as a financing source when expenses are incurred or assets are purchased. Exchange revenues from reimbursable services and intra-governmental reimbursable activity are recognized as earned when the good or service is provided and reflect the full cost of the good or service provided. Non-exchange revenue from user fees is recognized as earned in accordance with the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended. Customs may retain the user fee revenues and expend them as authorized by law for Customs inspector overtime and other activities directly related to the services to which the fees relate. An imputed financing source is also recognized to offset costs incurred by Customs but funded by another federal source, generally in the period in which the cost was incurred. Expenses are recognized when goods or services are received, when inventory is used, or assets depreciated, or amortized.

The Fiscal Year 2002 activities reported on the consolidated statement of net cost contain all resource costs assigned from Customs cost centers. All field operational cost centers were surveyed for time spent in the Passenger Processing, Trade Compliance, Outbound Operations and field Mission Support activities. For enforcement operational cost centers, the time spent in the activities was extracted from the Customs Electronic Data Warehouse. Time reported by the field and enforcement operational cost centers is also used to assign mission support and overhead costs to "front-line" activities.

Non-entity Revenue is recognized when the cash Customs is entitled to collect on behalf of the Federal Government is received. Primarily, these revenue collections result from current fiscal year activities. The significant types of revenues collected and related disbursements are described below:

- Duties: amounts collected on imported goods.
- User fees: amounts designed to maintain United States harbors, and to defray the cost of other miscellaneous service programs.
- Excise taxes: amounts collected on imported distilled spirits, wines and tobacco products, and other miscellaneous taxes collected on behalf of the Federal Government.
- Fines and penalties: amounts collected for violations of laws and regulations.
- Refunds: payments made to importers/exporters is primarily identified when the import entry is liquidated, a process in which Customs makes final determination of duties, taxes, fees and interest owed on the entry and compares it to the estimated amount previously determined by and paid by the importer/broker. Interest is included in the refund generally for the period of time between when the estimated amounts were received from the importer/broker and the time the entry is liquidated. When a refund is identified prior to liquidation, the refund from this remittance is funded from the duty, tax, or fee collection rather than from the Refunds and Drawback Account.
- Drawback: a remittance, in whole or in part, of duties, taxes, or fees. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid are subsequently exported from the United States or destroyed prior to entering the commerce of the United States. Depending on the type of claim, the claimant has up to six or eight years from the date of importation to file for drawback.

A financing source and expense for refunds and drawback is recognized when payment is made. The financing source, representing permanent, indefinite appropriation accounts used to fund the disbursement, is recorded as a decrease in the amount transferred to Treasury General Fund Accounts reported on the Statement of Custodial Activity.

An accrual adjustment is included to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable.

Customs will also take into custody, without risk or expense; merchandise termed "general order property," which for various reasons can not be legally entered into the U.S. commerce. Customs sole responsibility for the general order property is to ensure it does not enter the commerce of the United States. If general order property remains in Customs custody for a prescribed period of time, without payment of all estimated duties, storage and other charges, it is considered unclaimed and abandoned and can be sold by Customs at public auction. Auction sales revenue in excess of charges associated with the sale or storage of the item is remitted to the Treasury General

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Fund. In some cases, Customs incurs charges prior to the sale and funds these costs from entity appropriations. Regulations permit Customs to offset these costs of sale before returning excess amounts to Treasury. Proceeds from the sale of general order property totaled \$8.5 million and \$7.5 million for the years ended September 30, 2002 and 2001, respectively. Excess amounts returned to the Treasury General Fund average \$1.1 million.

2. Non-Entity Assets

Non-entity assets as of September 30, 2002 and 2001, consists of the following (in thousands):

	2002	2001
Intra-governmental		
Fund balance with Treasury	\$ 694,688	\$ 807,414
Accounts Rec. – Refund & Drawback	566,792	--
Total Intra-governmental	1,261,480	807,414
Cash and other monetary instruments	27,733	23,644
Duty and trade related receivables, net	1,171,043	900,852
Advances and prepayments	--	5
Property, plant and equipment	4,960	5,282
Total Non-Entity Assets	2,465,216	1,737,197
Total Entity Assets	3,115,354	2,565,985
Total Assets	\$ 5,580,570	\$ 4,303,182

3. Fund Balance with Treasury

Fund balance with Treasury as of September 30, 2002 and 2001, consists of the following (in thousands):

2002	Entity	Non-Entity	Totals
Appropriated Funds	\$ 1,438,620	\$ 41,742	\$ 1,480,362
Trust Funds	54,154	--	54,154
Special Funds	740,967	328,190	1,069,157
Deposit Funds	4,664	324,756	329,420
Totals	\$ 2,238,405	\$ 694,688	\$ 2,933,093
2001	Entity	Non-Entity	Totals
Appropriated Funds	\$ 929,775	\$ 488,817	\$ 1,418,592
Trust Funds	86,623	319	86,942
Special Funds	776,071	247,385	1,023,456
Deposit Funds	9,190	70,893	80,083
Totals	\$ 1,801,659	\$ 807,414	\$ 2,609,073

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Status of Fund Balance with Treasury as of September 30, 2002 and 2001, consists of the following (in thousands):

2002	Entity	Non-Entity	Totals
Unobligated balance available	\$ 501,738	\$ 694,688	\$ 1,196,426
Unobligated balance unavailable	16,540	--	16,540
Obligated balance not yet disbursed	1,080,487	--	1,080,487
Restricted unobligated funds	639,640	--	639,640
Totals	<u>\$ 2,238,405</u>	<u>\$ 694,688</u>	<u>\$ 2,933,093</u>
2001	Entity	Non-Entity	Totals
Unobligated balance available	\$ 399,540	\$ 807,414	\$ 1,206,954
Unobligated balance unavailable	13,140	--	13,140
Obligated balance not yet disbursed	749,339	--	749,339
Restricted unobligated funds	639,640	--	639,640
Totals	<u>\$ 1,801,659</u>	<u>\$ 807,414</u>	<u>\$ 2,609,073</u>

Entity amounts comprising the special fund balances result from Customs authority to assess and collect passenger and conveyance-related user fees, Customs authority to assess and collect fees associated with services performed at certain small airports or other facilities, and Customs authority to retain amounts needed to offset costs associated with collecting duties, taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by Customs. Customs is required to maintain \$30 million in its User Fees Account. Also, an additional \$640 million of the User Fees Account balance is restricted by law in its use to offset costs incurred by Customs until made available as provided in Appropriation Acts. As of September 30, 2002 and 2001: (1) Customs User Fees Account contained approximately \$728.2 million and \$755.5 million, respectively; (2) Customs Services at Small Airports account contained approximately \$876 thousand and \$3.7 million, respectively; and (3) the Refunds, Transfers and Expenses of Operation of Puerto Rico Account contained approximately \$11.9 million and \$16.9 million, respectively.

The entity trust fund balances result from Customs authority to use the proceeds from general order items sold at auction to offset specific costs incurred by Customs relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

The entity deposit fund balance represents amounts received as an advance that are not accompanied by an order. Once the order is received, the deposit fund balance is decreased.

The non-entity appropriated fund balance represents permanent, indefinite appropriations to pay refunds and drawback claims of duties, taxes, or fees. The balance is presented as a non-entity balance because the refund and drawback payments are associated with Customs custodial activity of collecting revenue on behalf of the Federal Government.

The non-entity special fund balance results from Customs authority to disburse monies received in connection with antidumping and countervailing (AD/CV) duty orders and findings to qualifying injured domestic industries.

The non-entity deposit fund balance represents collections for which final disposition has not been completed.

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4. Cash and Other Monetary Instruments

Cash and other monetary instruments as of September 30, 2002 and 2001, consist of the following (in thousands):

2002	Entity	Non-Entity	Totals
Imprest Funds	\$ 656	\$ --	\$ 656
Undeposited Collections	299	13,953	14,252
Monetary Instruments	--	13,780	13,780
Totals	<u>\$ 955</u>	<u>\$ 27,733</u>	<u>\$ 28,688</u>
2001	Entity	Non-Entity	Totals
Imprest Funds	\$ 672	\$ --	\$ 672
Undeposited Collections	433	15,557	15,990
Monetary Instruments	--	8,087	8,087
Totals	<u>\$ 1,105</u>	<u>\$ 23,644</u>	<u>\$ 24,749</u>

Undeposited collection balances represent timing differences between when cash relating to duties, taxes, fees, and other trade related collections are received and when the distribution of funds occurs. Cash can either be distributed to the General Fund, other Federal agencies, other governments, or returned to the importer/broker. The monetary instruments represents instruments importers/brokers provide to Customs in lieu of obtaining surety bonds.

5. Accounts Receivable, Net**Intra-governmental Accounts Receivable**

Accounts receivable due from other Federal agencies, as of September 30, 2002 and 2001, total \$16.6 million and \$11.8 million, respectively, and are considered fully collectible.

The \$567 million receivable due from Treasury, as of September 30, 2002, represents amounts to be provided by Treasury to fund accrued liabilities.

Accounts Receivables, Net

Receivables from reimbursable services are recognized for work, or services provided to a private party. By law, collections of these receivables can be credited to the appropriation accounts from which the related costs were paid. As of September 30, 2002 and 2001, reimbursable service receivables total \$6.2 million and \$2.9 million, respectively, and are considered fully collectible.

User fees are collected for inspectional processing of air and sea passengers and loaded railroad cars. Receivables accrue for airline and vessel fees on a quarterly basis and accrue for railroad fees on a monthly basis. Payment is due thirty days subsequent to the end of the quarter for airline and vessel fees, or sixty days subsequent to the end of the month for railroad fees. As of September 30, 2002 and 2001, user fee receivables total \$63.7 million and \$63.8 million, respectively, and are net of uncollectible amounts totaling \$7.9 million and \$7.2 million, respectively.

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6. Duty and Trade Related Receivables, Net

Receivables as of September 30, 2002 and 2001 are as follows (in thousands):

Receivables Category	2002		
	Gross Receivable	Amounts Uncollectible	Total Net Receivables
Duties	\$ 1,007,504	\$ (89,368)	\$ 918,136
Excise Taxes	59,964	(2,602)	57,362
User fees	68,949	(1,112)	67,837
Fines/penalties	382,588	(312,241)	70,347
Interest	66,361	(59,280)	7,081
Refunds and drawback	50,531	(251)	50,280
Totals	\$ 1,635,897	\$ (464,854)	\$ 1,171,043

Receivables Category	2001		
	Gross Receivable	Amounts Uncollectible	Total Net Receivables
Duties	\$ 814,454	\$ (55,654)	\$ 758,800
Excise Taxes	40,060	(1,213)	38,847
User fees	62,000	(2,616)	59,384
Fines/penalties	485,675	(448,090)	37,585
Interest	47,295	(41,186)	6,109
Refunds and drawback	548	(421)	127
Totals	\$ 1,450,032	\$ (549,180)	\$ 900,852

Customs assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. At the time importers bring merchandise into the United States, they are required to file Customs entry documents. Generally, within 10 working days after Customs releases the merchandise into the U.S. commerce, the importer is to submit an entry document with payment of estimated duties, taxes, and fees. A receivable of \$982 million and \$816 million was recorded for 552,328 entries and 454,208 entries for merchandise released into commerce on or before September 30, 2002 and 2001, respectively, for which payment was not received as of September 30, 2002 and 2001. There were an additional 2,364 entries and 741 entries for merchandise released into commerce on or before September 30, 2002 and 2001, respectively, for which a receivable amount could not be determined because the entry summary documentation describing the type, quantity, and value of the merchandise had not been received from the importers. It is Customs policy to track and demand payment of unpaid estimated duties, taxes and fees receivable amounts by establishing a liquidated damage case which generally results in a fines and penalty type receivable. Of the duty and trade related net receivable amounts at September 30, 2002 and 2001, approximately 92 percent and 93 percent, respectively, were collected by the end of the fourth week in October 2002 and first week in November 2001. In addition, there was an increase in the accounts receivable of \$50 million related to the supplemental duty bills for antidumping/countervailing duties, which was not applicable in fiscal year 2001.

In addition, Customs import specialists review selected entry summaries to determine whether importer estimates of duties, taxes, and fees were accurate or whether additional (supplemental) amounts are owed and should be billed. Customs regulations allow the importer 90 days from the bill date in which to file a protest to be reviewed by the Port Director and an application requesting further review of the protest by Customs Office of Regulations and Rulings challenging the assessment of supplemental duties, taxes, and fees. If the protest and application for further review are denied by the Port Director, the protestor has an additional 60 days from the denial date to file for a review of the application by the Commissioner of Customs. Consequently, supplemental accounts receivable balances are only recorded on outstanding claims when the protested period has elapsed or when a protest decision has been rendered in Customs favor.

The Entry Reconciliation Program, implemented October 1, 1998, allows importers to make entry of merchandise when certain information elements, such as dutiable value, are not fully determined at time of release of goods into the United States commerce. The importer files a reconciliation entry up to 15 months after the imported goods enter the United States commerce, which finalizes the entry data, and makes the appropriate financial and statistical adjustments. Customs has 4,106 reconciliation entries associated with over 1.1 million entry summaries. Until these reconciliation entries are liquidated, Customs cannot determine whether additional duties or fees are due from the importer.

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A fine or penalty is established when a violation of import/export law is discovered. Customs assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment the importer or surety has 60 days to either file a petition requesting a review of the assessment or make payment of the assessed amount. If a petition is received and Customs finds there are extenuating circumstances, such as an incorrect assessment, which warrants mitigation, relief is granted as prescribed by Customs mitigation guidelines and directives. As of September 30, 2002 and 2001, Customs had 6,418 and 7,167 fines and penalty cases, respectively, recorded as receivables. Customs is also tracking another 21,329 cases, for which a receivable was not established because: (1) the petition period had not expired; or (2) Customs had not reached agreement (relief granted or denied or court settlement) with the importer or surety as to the amount of damages (fines) or penalties owed. For the 21,329 and 23,400 cases still in petition phase as of September 30, 2002 and 2001, respectively, Customs identified approximately \$56 million and \$60 million respectively, as "actual loss of duties."

7. Inventory and Related Property**Operating Parts and Materials**

Operating parts and materials consist of parts and materials held for future consumption to repair and maintain Customs aircraft and vessels used in enforcement activities.

Operating parts and materials as of September 30, 2002 and 2001, consists of the following (in thousands):

<u>2002</u>	<u>Entity</u>	<u>Non-Entity</u>	<u>Totals</u>
Aircraft	\$ 55,783	\$ --	\$ 55,783
Vessels	4,189	--	4,189
Totals	<u>\$ 59,972</u>	<u>\$ --</u>	<u>\$ 59,972</u>
 <u>2001</u>	 <u>Entity</u>	 <u>Non-Entity</u>	 <u>Totals</u>
Aircraft	\$ 39,814	\$ --	\$ 39,814
Vessels	3,169	--	3,169
Totals	<u>\$ 42,983</u>	<u>\$ --</u>	<u>\$ 42,983</u>

Parts and materials acquired without reimbursement and consumed during the fiscal year ended September 30, 2002 and 2001, totaled \$33 million and \$35.7 million, respectively. Included in the September 30, 2002 and 2001 balances are parts and materials transferred to Customs without reimbursement totaling \$17.7 million for both years. When ultimately consumed in Customs operations, an operating expense is recorded.

Seized Property and Currency

Seized property results principally from Customs criminal investigations and passenger/cargo processing. Seized items are not considered assets of Customs and are not reported as assets in Customs financial statements. These items include contraband and counterfeit/prohibited items such as drugs and weapons that have no recorded value. Under the requirements of Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property, forfeited and seized property held by Treasury bureaus, including Customs, are disclosed on a consolidated basis in the financial statements of the Treasury Forfeiture Fund. Additionally as required by SFFAS No. 3, Customs, as the seizing agency, is required to account for the seized property until the property is forfeited, returned, or otherwise disposed. Substantially all seized property, except drugs and weapons, is managed and maintained under a contract with an unrelated entity, and is disclosed at a value estimated by Customs personnel or, in some cases, an independent appraiser. Depending upon the need for evidence, seized currency is either deposited to a Treasury suspense account or stored in a vault at a financial institution or Customs facility.

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Analysis of Change in Seized Property and Currency

The following information represents Customs seizure activity for Fiscal Year 2002. This information is consolidated with other Treasury bureaus and the U.S. Coast Guard and reported in the financial statements of the Treasury Forfeiture Fund. An analysis of change in Customs seized property and currency activity during Fiscal Year 2002 is as follows (dollars in thousands):

	Balance October 1		Seizures		Remissions	
	Value	No.	Value	No.	Value	No.
Currency and monetary instruments	\$ 132,635	--	\$ 194,577	--	\$ (63,343)	--
Marketable securities	10,866	--	7,441	--	(3,484)	--
Real property	7,189	40	3,641	30	(309)	(9)
General property	92,688	6,518	124,061	16,784	(99,254)	(5,742)
Vessels	1,932	38	4,188	95	(928)	(27)
Aircraft	1,206	6	30,277	18	(24,486)	(11)
Vehicles	21,907	1,833	45,386	7,916	(31,888)	(2,324)
Totals	<u>\$ 268,423</u>	<u>8,435</u>	<u>\$ 409,571</u>	<u>24,843</u>	<u>\$ (223,692)</u>	<u>(8,113)</u>

(a) Adjustments include reclassification of property categories and minor adjustments to beginning balance. Additionally, adjustments include property turned over to state and local or other Federal law enforcement agencies for prosecution or destruction prior to forfeiture. The Seizures (General Property) amount was adjusted by (\$100,093,388) for a subsequent event.

Analysis of Change in Material Non-Valued (Prohibited) Seized Property (a)

Category	Balance October 1			New Seizures			Remissions		
	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity
Cannabis									
(marijuana)	1,551	3,412	--	527,867	1,161,307	--	--	--	--
Cocaine	207	450	--	39,512	86,926	--	--	--	--
Heroin	28	61	--	2,784	6,125	--	--	--	--
Firearms	--	--	2,518	--	--	1,686	--	--	(1,103)
Pornography	--	--	14,797	--	--	658	--	--	(7)
Totals	<u>1,786</u>	<u>3,923</u>	<u>17,315</u>	<u>570,163</u>	<u>1,254,358</u>	<u>2,344</u>	<u>--</u>	<u>--</u>	<u>(1,110)</u>

(a) This schedule is presented for material non-valued (prohibited) property only. These items are retained and ultimately destroyed by Customs, and are not transferred to the Treasury Forfeiture Fund. The balance for cannabis, cocaine and heroin are presented by weight seized. The ending balance for firearms includes only those seized items that can actually be used as a firearm.

Forfeitures		Adjustments (a)		Value Changes		Balance September 30	
Value	No.	Value	No.	Value	No.	Value	No.
\$ (60,652)	--	\$ 544	--	\$ --	--	\$ 203,761	--
(433)	--	(57)	--	--	--	14,333	--
(3,925)	(20)	(188)	(24)	(827)	--	5,536	17
(18,197)	(9,608)	(6,136)	(1,484)	4,687	--	97,849	6,468
(2,389)	(51)	13	(3)	(91)	--	2,725	52
(35)	(1)	--	--	--	--	6,962	12
(19,084)	(5,540)	(1,118)	(487)	(250)	--	14,953	1,398
<u>\$ (104,715)</u>	<u>(15,220)</u>	<u>\$ (6,942)</u>	<u>(1,998)</u>	<u>\$ 3,474</u>	<u>--</u>	<u>\$ 346,119</u>	<u>7,947</u>

New Forfeitures			Adjustments			Balance September 30		
Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity
(529,187)	(1,164,211)	--	70	154	--	301	662	--
(39,248)	(86,346)	--	(33)	(66)	--	438	964	--
(2,794)	(6,147)	--	--	--	--	18	39	--
--	--	(713)	--	--	3,275	--	--	5,663
--	--	(602)	--	--	(14,499)	--	--	347
<u>(571,229)</u>	<u>(1,256,704)</u>	<u>(1,315)</u>	<u>37</u>	<u>88</u>	<u>(11,224)</u>	<u>757</u>	<u>1,665</u>	<u>6,010</u>

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Analysis of Change in Forfeited Property

The following information presents the status of items seized by Customs through the forfeiture process. This information is consolidated with other Treasury bureaus and the U.S. Coast Guard and reported on the financial statements of the Treasury Forfeiture Fund. An analysis of change in the forfeited property initially seized by Customs during Fiscal Year 2002 is as follows (dollars in thousands):

	Balance October 1 (a)		Forfeitures		Deposits/Sales		Disposals/Transfer	
	Value	No.	Value	No.	Value	No.	Value	No.
Currency/ monetary instruments	\$ 1,261	--	\$ 60,652	--	\$ (92,327)	--	\$ --	--
Marketable securities	5	--	433	--	(284)	--	--	--
Real property	7,989	31	3,925	20	(5,065)	(31)	--	--
General property	1,222	2,907	18,197	9,608	(11,803)	(1,867)	(400)	(236)
Vessels	263	23	2,389	51	(1,311)	(41)	(685)	(15)
Aircraft	79	1	35	1	(100)	(1)	--	--
Vehicles	3,716	1,641	19,084	5,540	(17,167)	(5,890)	(719)	(64)
Totals	<u>\$ 14,535</u>	<u>4,603</u>	<u>\$ 104,715</u>	<u>15,220</u>	<u>\$(128,057)</u>	<u>(7,830)</u>	<u>\$ (1,804)</u>	<u>(315)</u>

(a) The October 1 and September 30 balances reflect net realizable values. The Fiscal Year 2002 forfeitures, deposits/sales, disposals/transfers, destroyed, adjustments and value change balances reflect estimated values.

(b) Adjustments include reclassification of property categories and adjustments to beginning balances.

Analysis of Change in Material Non-Valued (Prohibited) Forfeited Property (a)

Category	Balance October 1			New Foreitures			Transfers		
	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity
Cannabis (marijuana)	131,244	288,275	--	529,187	1,164,211	--	(1,501)	(3,302)	--
Cocaine	15,356	33,741	--	39,248	86,346	--	(147)	(323)	--
Heroin	2,010	4,420	--	2,794	6,147	--	(64)	(141)	--
Firearms	--	--	469	--	--	713	--	--	(623)
Pornography	--	--	1,612	--	--	602	--	--	(11)
Totals	<u>148,610</u>	<u>326,436</u>	<u>2,081</u>	<u>571,229</u>	<u>1,256,704</u>	<u>1,315</u>	<u>(1,712)</u>	<u>(3,766)</u>	<u>(634)</u>

(a) This schedule is presented for material non-valued (prohibited) forfeited property only. These items are retained and ultimately destroyed by Customs, and are not transferred to the Treasury Forfeiture Fund. The balance for cannabis, cocaine and heroin are presented by weight seized. The ending balance for firearms includes only those seized items that can actually be used as a firearm.

Destroyed		Adjustments (b)		Value Change		Fair Value Adjustment		Balance September 30 (a)	
Value	No.	Value	No.	Value	No.	Value	No.	Value	No.
\$ --	--	\$ 31,050	--	\$ --	--	\$ --	--	\$ 636	--
--	--	--	--	--	--	--	--	154	--
--	--	(527)	5	277	--	65	--	6,664	25
(52,202)	(7,681)	64,425	201	(776)	--	(14,858)	--	3,805	2,932
--	(2)	266	3	(75)	--	(358)	--	489	19
--	--	21	--	--	--	--	--	35	1
(3)	(160)	914	(10)	(108)	--	(2,605)	--	3,112	1,057
<u>\$(52,205)</u>	<u>(7,843)</u>	<u>\$ 96,149</u>	<u>199</u>	<u>\$ (682)</u>	<u>--</u>	<u>\$(17,756)</u>	<u>--</u>	<u>\$ 14,895</u>	<u>4,034</u>

Destroyed			Adjustments			Balance September 30		
Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity	Weight (kg.)	Weight (lbs.)	Quantity
--	--	--	(603,391)	(1,326,998)	--	55,539	122,186	--
--	--	--	(35,033)	(77,031)	--	19,424	42,733	--
--	--	--	(1,519)	(3,340)	--	3,221	7,086	--
--	--	--	--	--	(178)	--	--	381
--	--	--	--	--	(2,091)	--	--	112
<u>--</u>	<u>--</u>	<u>--</u>	<u>(639,943)</u>	<u>(1,407,369)</u>	<u>(2,269)</u>	<u>78,184</u>	<u>172,005</u>	<u>493</u>

Department of the Treasury, United States Customs Service

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8. Property, Plant and Equipment

Property, plant and equipment as of September 30, 2002 and 2001, consists of the following (in thousands):

Categories	Useful Life (in years)	2002		
		Acquisition Cost	Accumulated Depreciation/ Amortization	Net Book Value
Aircraft	12 to 20	\$ 410,565	\$ (245,557)	\$ 165,008
ADP Mainframe	5	10,238	(8,134)	2,104
ADP Non-mainframe	5	29,929	(22,115)	7,814
ADP Software	5	179,125	(47,740)	131,385
Vehicles	6	119,556	(49,559)	69,997
Vessels	5 to 10	13,579	(11,567)	2,012
Land	N/A	4,470	--	4,470
Structures, Facilities (a)	30	49,899	(18,294)	31,605
Leasehold Improvements	2 to 30	80,299	(25,853)	54,446
Construction in Progress	N/A	175,134	--	175,134
Radio Communications	5	36,617	(34,847)	1,770
X-Ray/Lab Equipment	7	56,237	(30,537)	25,700
Assets under Capital Lease	5	10,595	(9,640)	955
Office Equipment and Other	5	81,380	(59,882)	21,498
Totals – Entity		1,257,623	(563,725)	693,898
Totals – Non-Entity		10,600	(5,640)	4,960
Totals		<u>\$ 1,268,223</u>	<u>\$ (569,365)</u>	<u>\$ 698,858</u>

Categories	Useful Life (in years)	2001		
		Acquisition Cost	Accumulated Depreciation/ Amortization	Net Book Value
Aircraft	12 to 20	\$ 412,629	\$ (229,442)	\$ 183,187
ADP Mainframe	5	20,301	(16,012)	4,289
ADP Non-mainframe	5	26,907	(17,188)	9,719
ADP Software	5	146,578	(29,350)	117,228
Vehicles	6	91,917	(42,361)	49,556
Vessels	5 to 10	19,178	(17,262)	1,916
Land	N/A	5,338	--	5,338
Structures, Facilities (a)	30	50,867	(17,020)	33,847
Leasehold Improvements	20 to 30	53,177	(21,264)	31,913
Construction in Progress	N/A	124,333	--	124,333
Radio Communications	5	37,795	(36,370)	1,425
X-Ray/Lab Equipment	7	51,228	(25,807)	25,421
Assets Under Capital Lease	5	11,197	(9,500)	1,697
Office Equipment and Other	5	66,286	(51,094)	15,192
Totals – Entity		1,117,731	(512,670)	605,061
Totals – Non-Entity		9,560	(4,278)	5,282
Totals		<u>\$ 1,127,291</u>	<u>\$ (516,948)</u>	<u>\$ 610,343</u>

(a) Includes four multi-use heritage assets located in Puerto Rico with an acquisition value of \$534 thousand.

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9. Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary or other resources represent amounts owed in excess of available appropriated or other amounts. The liquidation of liabilities not covered by budgetary or other resources is dependent on future congressional appropriations. The September 30, 2002 and 2001, liabilities not covered by budgetary resources consists of the following (in thousands):

	2002	2001
Intra-governmental accounts payable	\$ 52,893	\$ 47,348
Workers' compensation	275,455	271,621
Payroll and benefits	114,556	105,882
Capital leases and commercial software license agreements	101,567	118,872
Other	5,077	3,523
Total Liabilities Not Covered By Budgetary Resources	549,548	547,246
Total Liabilities Covered By Budgetary Resources	2,674,903	1,978,975
Total Liabilities	<u>\$ 3,224,451</u>	<u>\$ 2,526,221</u>

The intra-governmental accounts payable amount is the accrued workers' compensation liability to the U.S. Department of Labor. The workers' compensation amount is the actuarial liability.

10. Refunds Payable & Advances from Others

Refunds payable consists of amounts owed for refunds of duty and other trade related activity and drawback claims. These liabilities are principally funded from the Refunds and Drawback Account. The September 30, 2002 and 2001, accrued liability consists of the following (in thousands):

	2002	2001
Refunds	\$ 564,177	\$ 106,599
Drawback claims	35,138	14,488
Totals	<u>\$ 599,315</u>	<u>\$ 121,087</u>

The Fiscal Years 2002 and 2001 refunds payable includes a \$36.2 million and \$35.9 million, respectively, accrued liability relating to the Trade and Development Act of 2000. This act requires refunds of duties paid on certain wool products to importers over the next three years.

An estimated \$211.1 million liability relating to the renewal of the Generalized System Preference (GSP) legislation is included in the refunds payable. This Act requires refunds of amounts collected by Customs for specific trade activity occurring after September 30, 2001. The GSP disbursements will be made in Fiscal Year 2003.

Customs accrues a liability for refunds and drawback claims approved at year-end, but paid subsequent to year-end. Payments made to importers/exporters are primarily identified when the import entry is liquidated, a process in which Customs makes a final determination of duties, taxes, and fees owed on the entry. Due to non-liquidation of the entries, the amount to be refunded is undetermined. Therefore, a historical calculated average was used to determine a ratio for estimating the receivable and payable to be recorded. Using this average, Customs has estimated \$35.1 million as a payable.

The Entry Reconciliation Program, implemented October 1, 1998, allows importers to make entry of merchandise when certain information elements, such as dutiable value, are not fully determined at time of release of goods into the U.S. commerce. The importer files a reconciliation entry up to 15 months after the imported goods enter the United States commerce, which finalizes the entry data, and makes the appropriate financial and statistical information. Customs has 4,106 reconciliation entries, associated with over 1.1 million refunds. Customs automated systems now have the capability to liquidate reconciliation entries the same as other entries.

Advances from Others

The increase in fiscal year 2002 advances from others is due to \$233 million of unliquidated anti-dumping/countervailing duties.

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11. Payroll and Benefits

The payroll and benefits liability as of September 30, 2002 and 2001, consists of the following (in thousands):

	2002	2001
Payroll	\$ 41,637	\$ 91,813
Benefits	846	2,073
Annual and other leave liability	114,556	105,882
Continuation of pay	--	600
Totals	<u>\$ 157,039</u>	<u>\$ 200,368</u>

12. Other Liabilities

Other liabilities as of September 30, 2002 and 2001, consists of the following (in thousands):

	2002	2001
Probable contingencies (Note 15)	\$ 8,996	\$ 7,439
Conveyance, passenger, fees and other	11,249	10,057
Continuation of pay	--	--
Totals	<u>\$ 20,245</u>	<u>\$ 17,496</u>

13. Leases**Operating Leases**

Customs leases various facilities and equipment under leases accounted for as operating leases. The lease expense under these arrangements totaled \$196 million and \$181 million for the years ended September 30, 2002 and 2001, respectively.

The leased items consist of offices, warehouses, vehicles, and other equipment. Much of the office space occupied by Customs is either owned by the Federal Government or is leased by the General Services Administration (GSA) from commercial sources. Customs is not committed to continue to pay rent to GSA beyond the period occupied providing proper advance notice to GSA is made and unless the space occupied is designated as unique space only for Customs operations. However, it is expected that Customs will continue to occupy and lease office space from GSA in future years and that the lease charges will be adjusted annually to reflect operating costs incurred by GSA. Lease amounts paid to GSA during Fiscal Year 2002 and 2001 were \$195 million and \$180 million, respectively.

As of September 30, 2002 and 2001, future minimum lease commitments under non-cancelable operating leases for equipment are as follows (in thousands):

FY	2002	2001
2002	\$ --	\$ 6
2003	--	--
2004	--	--
2005	--	--
2006	--	--
2007	--	--
Total future minimum lease	<u>\$ --</u>	<u>\$ 6</u>

Department of the Treasury, United States Customs Service

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Capital Leases and Commercial Software License Agreements

Customs has a number of capital lease and software license fee agreements primarily involving mainframe software licenses. The liabilities associated with these capital lease and software license agreements are reflected in the accompanying financial statements based upon the present value of the future minimum lease payments. As of September 30, 2002 and 2001, the aggregate capitalized cost of the agreements still subject to lease is \$143.7 million and \$144.3 million, respectively. For FY 2002 and 2001, the capital lease agreements are included in the total assets acquired under capital lease in the amount of \$10.6 million and \$11.2 million, respectively. As of September 30, 2002 and 2001, the aggregate cost of the license agreements capitalized for both years is \$133.1 million. These agreements are included in the capitalized Software. Certain license agreements are cancelable upon certain funding conditions.

	2002		
	Acquisition Cost	Accumulated Depreciation	Net Book Value
Land & Buildings	\$ --	\$ --	\$ --
Machinery & Equipment	10,557	(9,924)	633
Other (Capitalized Software License Fees)	133,133	(41,854)	91,279
Totals	<u>\$ 143,690</u>	<u>\$ (51,778)</u>	<u>\$ 91,912</u>

	2001		
	Acquisition Cost	Accumulated Depreciation	Net Book Value
Land & Buildings	\$ --	\$ --	\$ --
Machinery & Equipment	11,197	(9,500)	1,697
Other (Capitalized Software License Fees)	133,133	(26,627)	106,506
Totals	<u>\$ 144,330</u>	<u>\$ (36,127)</u>	<u>\$ 108,203</u>

Future minimum lease payments under the capitalized leases and commercial off-the-shelf license agreements and the present value of the minimum lease obligation as of September 30, 2002, are as follows (in thousands):

FY	2002
2003	\$ 13,507
2004	16,915
2005	18,715
2006	17,981
2007	17,981
Beyond 2007	53,944
Total future minimum license	139,043
Less: Imputed interest	37,476
Total net present value of software license agreements	<u>\$ 101,567</u>

Substantially all of the net present value of capital lease obligations and software license agreements are expected to be funded from future sources.

14. Injured Domestic Industries

The Continued Dumping and Subsidy Offset Act of 2000, P.L. 106-387, Title X, enacted in Fiscal Year 2001 calls for Customs to disburse monies received in connection with antidumping and countervailing (AD/CV) duty orders and findings to qualifying injured domestic industries. During Fiscal Year 2002 and 2001, Customs collected \$312 million and \$247.4 million, respectively, in AD/CV duty and recorded the liability.

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15. Commitments and Contingencies

Customs is party to various administrative proceedings, legal actions, and claims brought by or against it. Any financially unfavorable administrative or court decision will normally be funded from either: (1) Customs appropriation for refunds and drawback for trade litigation issues; (2) various claims and judgement funds maintained by Treasury; or (3) Customs salary and expense appropriation. It is the opinion of Customs management and legal counsel that the ultimate resolution of these proceedings, legal actions, and claims will not materially affect the financial statements.

Customs is involved in various actions incidental to its operations. The probable and reasonably possible liabilities as of September 30, 2002 and 2001, consist of the following (in thousands):

Funded By:	2002		2001	
	Probable	Reasonably Possible	Probable	Reasonably Possible
Customs Appropriations	\$ 2,769	\$ 46,681	\$ 360	\$ 13,095
Refund & Drawback Appropriation	3,919	57,413	4,515	51,634
Other Claim/Judgment Funds	2,308	57,165	2,564	52,536
Totals	<u>\$ 8,996</u>	<u>\$ 161,259</u>	<u>\$ 7,439</u>	<u>\$ 117,265</u>

Customs is generally liable to the Department of Defense (DOD) for damage or loss to aircraft on loan to Customs from DOD. As of September 30, 2002 and 2001, Customs had 16 loaned aircraft with an acquisition value of \$94.4 million.

In accordance with Public Law 101-510, Customs is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is canceled may be paid from an unexpired appropriation that is available for the same general purpose. At September 30, 2002, Customs canceled \$12.2 million from Fiscal Year 1997 annual appropriations, of which \$3.8 million was obligated. At September 30, 2001, Customs canceled \$13.5 million from Fiscal Year 1996 annual appropriations, of which \$5.1 million was obligated. For the years ended September 30, 2002 and 2001, Customs paid \$63 thousand and \$29 thousand, respectively, for obligations associated with appropriations that were canceled in prior years. Based on historical activity, Customs estimates obligations related to canceled appropriations that will be paid from future appropriations would not exceed \$1 million in any fiscal year.

Customs was authorized to issue various grants and cooperative agreements totaling \$4.3 million and \$3.8 million through September 30, 2002 and 2001, respectively, of which \$4.3 million and \$3.8 million was obligated. As of September 30, 2002 and 2001, respectively, a total of \$3.2 million and \$2.4 million has been disbursed. The remaining grant and cooperative agreement funds are available for expenditure through May 31, 2004.

Customs estimated future drawback claims and refunds relating to custodial revenue collections received during Fiscal Year 2002 and in prior years, at \$972 million and \$819 million, respectively. As of September 30, 2001, Customs estimated future drawback claims and refunds relating to custodial revenue collections received during Fiscal Year 2001 and in prior years, at \$987 million and \$844 million, respectively.

There are various other trade issues resolved by other Federal Agencies, such as the Department of Commerce, which may result in refunds of duties, taxes, and fees from the Refunds and Drawback Account. Until such time as a decision is reached by the other agencies, Customs does not have sufficient information to estimate a contingent liability amount.

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16. Net Position

Net Position as of September 30, 2002, consists of the following (in thousands):

	2002			
	Special Funds	Trust Funds	Appropriated Funds	Totals
Unexpended Appropriations				
Unobligated – Available	\$ --	\$ 32,423	\$ 405,091	\$ 437,514
Unobligated – Unavailable	--	--	16,540	16,540
Obligations/Undelivered Orders	1,214	18,817	888,841	908,872
Total Unexpended Appropriations	1,214	51,240	1,310,472	1,362,926
Cumulative Results of Operations	793,802	35,155	164,236	993,193
Totals	<u>\$ 795,016</u>	<u>\$ 86,395</u>	<u>\$ 1,474,708</u>	<u>\$ 2,356,119</u>

17. Statement of Net Cost

The programs displayed are equivalent to the missions listed in the U.S. Customs Service Fiscal Year 1997-2002 Strategic Plan.

Passenger Processing

To ensure compliance by targeting, identifying, and examining high-risk travelers, and to allow the expeditious movement of low-risk travelers. The goal of Passenger Processing is to achieve at least a 99 percent rate of compliance with Customs laws and regulations for passengers and crew of commercial and non-commercial conveyances entering or leaving the United States.

Trade Compliance

To maximize compliance through a balanced program of informed compliance, targeted enforcement actions, and the facilitation of complying cargo. Customs key goals are to: (a) increase compliance with U.S. trade laws to at least 90 percent overall and to at least 98 percent in primary focus industries, (b) continue to collect at least 99 percent of the revenue, (c) increase customer satisfaction, (d) decrease per unit cost, and (e) improve the accuracy of key statistics.

Outbound

To facilitate international trade, while achieving the highest degree of compliance with United States export requirements in order to protect the U.S. national security, economic interests, and health and safety of the American people. The Outbound Process is responsible for the series of Customs operations related to the movement of merchandise and conveyances outbound from the United States.

Enforcement

To prevent the smuggling of narcotics and other contraband into the United States by creating an effective interdiction, intelligence, and investigation capability that disrupts and dismantles smuggling operations. Also to identify, disrupt, and dismantle the systems and criminal organizations that launder the proceeds generated by smuggling, trade fraud, and export violations.

Department of the Treasury, United States Customs Service

Notes to Financial Statements

Unaudited

Gross costs and earned revenue by budget functional classification for the years ended September 30, 2002 and 2001, consists of the following (in thousands):

Functional Classification	2002		
	Gross Cost	Earned Revenue	Net Cost
Administration of Justice	\$ 3,145,754	\$ (149,054)	\$ 2,996,700
General Government	47,115	(45,935)	1,180
Totals	<u>\$ 3,192,869</u>	<u>\$ (194,989)</u>	<u>\$ 2,997,880</u>

Functional Classification	2001		
	Gross Cost	Earned Revenue	Net Cost
Administration of Justice	\$ 2,814,282	\$ (129,271)	\$ 2,685,011
General Government	30,046	(45,265)	(15,219)
Totals	<u>\$ 2,844,328</u>	<u>\$ (174,536)</u>	<u>\$ 2,669,792</u>

Customs and Treasury have a \$30.2 million and \$29.1 million interagency agreement for the Interagency Crime and Drug Enforcement (ICDE) appropriation to reimburse Customs for the expenses necessary for the detection and investigation of individuals involved in organized crime drug trafficking as of September 30, 2002 and 2001, respectively. Customs expenses for the years ended September 30, 2002 and 2001, to support this activity totaled approximately \$32.6 million and \$34.5 million, respectively, and were funded from the ICDE and Customs salaries and expense appropriation.

Expenses by object class code classification for the years ended September 30, 2002 and 2001, consist of the following (in thousands):

Expenses	2002	2001
Personnel compensation and benefits	\$ 1,828,388	\$ 1,825,364
Travel and transportation	82,429	59,235
Rent, communication, and utilities	249,690	223,409
Printing and reproduction	4,328	4,283
Purchases of evidence and information	13,203	10,991
Contractual services	527,143	370,778
Supplies and materials	84,458	47,405
Equipment not capitalized	143,263	102,398
Depreciation expense	93,836	81,982
Other expenses	166,131	118,483
Totals	<u>\$ 3,192,869</u>	<u>\$ 2,844,328</u>

18. Statement of Budgetary Resources

As of September 30, 2002, budgetary resources obligated for undelivered orders total \$975.5 million. Customs did not have any borrowing or contract authority, and did not have any repayment requirements, financing sources for repayments, or any other terms of borrowing authority used.

Adjustments to budgetary resources available at the beginning of Fiscal Year 2002 consists of the following (in thousands):

	2002
Recoveries of prior year obligations	\$ 87,616
Cancellation of expired and no-year accounts	(12,207)
Enacted rescissions of prior year balances	(6,985)
Totals	<u>\$ 68,424</u>

Department of the Treasury, United States Customs Service

Notes to Financial Statements

Unaudited

19. Statement of Financing

The Financing Sources Yet to be Provided presented on the Statement of Financing represents the change between the beginning and ending balances for Liabilities Not Covered by Budgetary and Other Resources presented on the balance sheet.

20. Refunds and Other Payments

Disbursements from the Refunds and Drawback account for the years ended September 30, 2002 and 2001, consist of the following (in thousands):

	2002	2001
Refunds	\$ 1,064,315	\$ 529,124
Drawback	425,438	403,180
Totals	<u>\$ 1,489,753</u>	<u>\$ 932,304</u>

The disbursements include interest payments of \$125.1 million and \$71.7 million for Fiscal Years 2002 and 2001, respectively. In certain instances, a refund may be identified prior to liquidation for amounts remitted by the importer. These refunds are funded from the collections rather than the Refunds and Drawback account. During Fiscal Years 2002 and 2001, these refunds totaled \$273 million and \$71 million, respectively.

Amounts refunded during Fiscal Years 2002 and 2001 identified by entry year consist of the following (in thousands):

Entry Year	2002	2001
2002	\$ 755,650	\$ --
2001	184,564	424,941
2000	132,254	224,418
1999	71,429	70,885
Prior Years	345,856	212,060
Totals	<u>\$ 1,489,753</u>	<u>\$ 932,304</u>

The disbursement totals for refunds includes antidumping and countervailing duties collected that are refunded pursuant to rulings by the Department of Commerce (Commerce). Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. commerce at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. These duties are refunded when Commerce issues a decision in favor of the foreign industry.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from Commerce. Antidumping and countervailing duty refunds and associated interest refunded during Fiscal Years 2002 and 2001 were as follows (in thousands):

	2002	2001
Antidumping and countervailing duty refunds	\$ 244,639	140,169
Interest	71,998	28,007
Total antidumping and countervailing duty refunds	<u>\$ 316,637</u>	<u>168,176</u>

Required Supplementary Information

A. Federal Account Symbols and Titles

ENTITY FUNDS – Customs entity operations are funded principally through the following accounts:

General Funds

20X0602	Salaries and Expenses
20 / 0602	Salaries and Expenses, annual and multi-year accounts
20X0604	Operation and Maintenance, Air and Marine Interdiction Program
20 / 0604	Operation and Maintenance, Air and Marine Interdiction Program, multi-year accounts
20X0608	Customs Air Interdiction Facilities, Construction, Improvements and Related Expenses
20X0609	Air and Marine Interdiction Programs, Procurement
20X0610	Automation Modernization

Deposit Funds

20X6500.6	Advances W/O Orders Non-Federal Sources
20F3880.6	Unavailable Chk Cancel (Suspense)
20F3885.6	Undistributed Intergovernmental Payment

Special Funds

20X5687	Refunds, Transfers and Expenses of Operations, Puerto Rico
20X5694	Customs Services at Small Airports
205694	User Fees – Small Airports
20X5695	Customs User Fees Account, U.S. Customs Service
205695.3	Customs Merchandise Processing Fee

Trust Funds

20X8529	Violent Crime Reduction Program
20X8789	Refunds, Transfers, Expenses, Unclaimed, Abandoned and Seized Goods
20X8870	Harbor Maintenance Fee Collection

NON-ENTITY FUNDS – Customs records non-entity activity in the following accounts:

General Fund Receipt Accounts

121010	Fines, Penalties & Forfeitures, Agriculture Laws, Department of Agriculture
200152	Excise Taxes
200310	Duties on Imports
200311	Tonnage Duty Fees
201040	Fines, Penalties and Forfeitures, Customs, Commerce and Antitrust Laws
201060	Forfeitures of Unclaimed Money and Property
201210	Contributions to Conscience Fund
201435	General Fund Proprietary Interest, Not Otherwise Classified
203200	Collections of Receivables from Canceled Accounts
203220	General Fund Proprietary Receipts, Not Otherwise Classified, All Other
272441	O/T Services Federal Communications Commission
20F3845.06	Proceeds of Sale, Personal Property
20F3875.6	BCA Suspense Account
613220	General Fund Proprietary Receipts, Not Otherwise Classified, Consumer Product Safety Commission
753220	General Fund Proprietary Receipts, Not Otherwise Classified, All Other, Dept. of Health & Human Services

Deposit Funds

12X6148	Assessments on Imports of Beef and Pork Products, Agriculture Marketing Services, Dept. of Agriculture
20X6157	Duties Collected for the Virgin Islands Government
20X6512.6	Customs Programs Escrow

Revolving Funds

04X4505.01	Revolving Fund, Government Printing Office
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Special Fund and Special Fund Receipt Accounts

12X5161	Agriculture Quarantine Inspection User Fees Account, Animal and Plant Health Inspection Service, USDA
14X5137.2	Import Duties on Arms and Ammunition, Migratory Birds Conservation Account, U.S. Fish and Wildlife
205209	30% of Customs Duties, Funds for Strengthening Markets, Income and Supply
20X5687.001	Deposits, Duties and Taxes, Puerto Rico
20X5688.1	Continued Dumping and Subsidy Offset
205688	Antidumping and Countervailing Duties, Continued Dumping and Subsidy Offset

Trust Funds

208789.001	Proceeds of Sales of Unclaimed, Abandoned, and Seized Goods
20X8863	Harbor Maintenance Trust Fund

General Funds

20X0603	Refunds and Drawback
20X0903	Refunding Internal Revenue Collections
20 / 0611	Wool Manufacturer Payments

B. Statement of Budgetary Resources

Budgetary resources disaggregated by major accounts for the year ended September 30, 2002, consists of the following (in thousands):

	Appropriated Funds	Trust Funds	Other Funds	Total
Budgetary Resources				
Budget authority				
Appropriations received	\$ 2,134,064	\$ --	\$ 1,350,366	\$ 3,484,430
Net Transfers	985,847	3,000	(954,766)	34,081
Total Budget Authority	3,119,911	3,000	395,600	3,518,511
Unobligated Balance				
Beginning of period	290,691	37,285	724,345	1,052,321
Net transfers	46,870	--	--	46,870
Total Unobligated Balance	337,561	37,285	724,345	1,099,191
Spending authority from offsetting collections				
Earned				
Collected	489,682	410	4,810	494,902
Receivables from Federal Sources	5,886	42	46	5,974
Total Earned	495,568	452	4,856	500,876
Change in Unfilled Customer Orders				
Advance received	(179)	--	--	(179)
Without advance from federal sources	21,141	(450)	--	20,691
Total Change in Unfilled Customer Orders	20,962	(450)	--	20,512
Transfers from Trust Funds	3,000	--	--	3,000
Total spending authority from offsetting collections	519,530	2	4,856	524,388
Adjustments				
Recoveries of prior year obligations	78,303	3,036	6,277	87,616
Permanently not available	(19,076)	(116)	--	(19,192)
Total Adjustments	59,227	2,920	6,277	68,424
Total Budgetary Resources	<u>\$ 4,036,229</u>	<u>\$ 43,207</u>	<u>\$ 1,131,078</u>	<u>\$ 5,210,514</u>
Status of Budgetary Resources				
Obligations Incurred				
Direct	\$ 3,095,873	\$ 10,784	\$ 422,370	\$ 3,529,027
Reimbursable	518,725	--	4,844	523,569
Total Obligations Incurred	3,614,598	10,784	427,214	4,052,596
Unobligated balance available	405,091	32,423	64,224	501,738
Unobligated balance not available	16,540	--	639,640	646,180
Total Status of Budgetary Resources	<u>\$ 4,036,229</u>	<u>\$ 43,207</u>	<u>\$ 1,131,078</u>	<u>\$ 5,210,514</u>
Relationship of Obligations to Outlays				
Obligated balance, net – beginning of period	\$ 639,757	\$ 48,372	\$ 51,726	\$ 739,855
Obligated balance, net – end of period				
Accounts Receivable	(34,564)	(42)	(269)	(34,875)
Unfilled Customer Orders from Federal Sources	(78,115)	(1,606)	--	(79,721)
Undelivered Orders	931,830	20,416	23,298	975,544
Accounts Payable	198,492	1,010	50,325	249,827
Outlays				
Disbursements	\$ 3,131,382	\$ 36,749	\$ 399,262	\$ 3,567,393
Collections	(492,503)	(410)	(4,810)	(497,723)
Net Outlays	<u>\$ 2,638,879</u>	<u>\$ 36,339</u>	<u>\$ 394,452</u>	<u>\$ 3,069,670</u>

C. Petitioned and Protested Schedule

An analysis of the changes in petitioned and protested assessed amounts during Fiscal Years 2002 and 2001 is as follows (in thousands):

	2002					
	Balance October 1	Additional Assessments	Protest in Favor of Debtor	Net Reduction Administrative Process	Additional Receivable	Balance September 30
Duties	\$ 46,001	\$ 237,739	\$ (46,336)	\$ (21,107)	\$ (64,626)	\$ 151,671
Taxes	219	931,329	(18,234)	(1,403)	(911,439)	472
Fees	542	18,397	(1,172)	(432)	(16,709)	626
Fines/Penalties	2,291,751	928,000	(713,411)	(351)	(1,354,120)	1,151,869
Interest	30,134	58,012	(14,349)	(4,453)	(39,264)	30,080
Totals	<u>\$ 2,368,647</u>	<u>\$ 2,173,477</u>	<u>\$ (793,502)</u>	<u>\$ (27,746)</u>	<u>\$ (2,386,158)</u>	<u>\$1,334,718</u>

	2001					
	Balance October 1	Additional Assessments	Protest in Favor of Debtor	Net Reduction Administrative Process	Additional Receivable	Balance September 30
Duties	\$ 43,226	\$ 46,736	\$ (13,926)	\$ (3,584)	\$ (26,451)	\$ 46,001
Taxes	661	423	(194)	(582)	(89)	219
Fees	594	289	(425)	202	(118)	542
Fines/Penalties	1,612,284	1,703,007	(573,710)	(216)	(449,614)	2,291,751
Interest	28,069	17,789	(8,648)	(1,322)	(5,754)	30,134
Totals	<u>\$ 1,684,834</u>	<u>\$ 1,768,244</u>	<u>\$ (596,903)</u>	<u>\$ (5,502)</u>	<u>\$ (482,026)</u>	<u>\$ 2,368,647</u>

Customs reviews selected entry documentation to determine whether importer payment estimates of duties, taxes, and fees were accurate or whether additional supplemental amounts are owed and should be billed. Customs regulations allow the importer 90 days from the bill date in which to file a protest to be reviewed by the Port Director and an application requesting further review of the protest by Customs Office of Regulations and Rulings challenging the assessment of supplemental duties, taxes, and fees. If the protest and application for further review are denied by the Port Director, the protestor has an additional 60 days from the denial date for a review of the application by the Commissioner of Customs. Consequently, Customs recognizes accounts receivables only when the protested period has elapsed or when a protest decision has been rendered in Customs favor.

Additionally, importers and their sureties also have the option to petition for relief after receipt of Customs notice that a fine or penalty has been assessed when a violation of law or regulation is discovered. The importer or surety has 60 days to file a petition for relief or make payment of the assessed amount. If a petition is received and Customs finds there are extenuating circumstances, such as an incorrect assessment, which warrants mitigation, relief is granted as prescribed by Customs mitigation guidelines and directives. Consequently, Customs recognizes accounts receivables only when the petition period has elapsed or when a petition decision has been rendered.

D. Deferred Maintenance

Deferred maintenance is maintenance that was not performed when it should have been or was scheduled to be performed, and is delayed until a future period. Maintenance includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable service and achieves its useful life. Deferred maintenance on property, plant and equipment as measured by condition assessment survey, is comprised of (in thousands):

	2002		2001	
	Condition Assessment	Deferred Maintenance	Condition Assessment	Deferred Maintenance
Building and Structures	Good	\$ 42	Fair	\$ 33
Aircraft		--		--
Vehicles	Good	34	Fair	20
Vessels	Good	--	Fair	1,800
Totals		<u>\$ 76</u>		<u>\$ 1,853</u>

E. Intra-governmental Assets, Liabilities, Revenue and Costs

Balances representing intra-governmental asset, liability, revenue and cost activity consist of the following (in thousands):

Intra-governmental Amounts – Assets

Partner Agency	2002		2001	
	Fund Balance with Treasury	Accounts Receivable/Advances	Fund Balance with Treasury	Accounts Receivable/Advances
Department of the Treasury	\$ 2,933,093	\$ --	\$ 2,609,073	\$ --
Treasury Forfeiture Fund	--	11,144	--	9,738
Financial Crimes Enforcement Network	--	1	--	32
U.S. Secret Service	--	8	--	--
U.S. Mint	--	58	--	--
Alcohol, Tobacco & Firearms	--	--	--	3
Bureau of Public Debt	--	26	--	--
Departmental Offices	--	18,963	--	23,098
Total Department of the Treasury	<u>2,933,093</u>	<u>30,200</u>	<u>2,609,073</u>	<u>32,871</u>
Department of Defense	--	1,337	--	836
Department of Health & Human Services	--	19	--	13
Agency for International Development	--	101	--	8
Department of Transportation	--	127	--	59
United States Postal Service	--	--	--	20
Federal Deposit Insurance Corp	--	--	--	--
General Services Administration	--	--	--	4
Department of State	--	3,566	--	722
Department of Justice	--	109	--	59
Office of Personnel Management	--	--	--	3
National Security Agency	--	--	--	5
Social Security Administration	--	--	--	2
Office of Housing & Urban Development	--	--	--	--
Central Intelligence Agency	--	1	--	1
Environmental Protection Agency	--	--	--	1
Department of Commerce	--	30	--	--
Department of Labor	--	1,622	--	--
Department of Energy	--	93	--	--
Total	<u>\$ 2,933,093</u>	<u>\$ 37,205</u>	<u>\$ 2,609,073</u>	<u>\$ 34,604</u>

Intra-governmental Amounts – Liabilities

Partner Agency	2002		2001	
	Accounts Payable	Other	Accounts Payable	Other
General Fund	\$ --	\$ 1,200,030	\$ --	\$ 1,283,917
Bureau of Public Debt/Franchise Funds	--	--	9	--
Internal Revenue Service	--	--	23	--
Federal Law Enforcement Training Center	1,265	--	812	--
Departmental Offices	--	--	133	--
Financial Management Service	--	--	--	--
Total Department of the Treasury	1,265	1,200,030	977	1,283,917
U.S. Equal Employment Opportunity Commission	--	--	(1)	--
Department of Defense	3,136	469	2,181	1,176
National Aeronautics & Space Administration	--	--	--	--
Department of Health and Human Services	45	--	--	--
Department of Transportation	--	--	--	--
General Services Administration	--	2,740	--	164
Social Security Administration	--	1	--	1
Office of Personnel Management	--	5,527	--	12,872
Department of State	--	6,546	--	10,737
Department of Labor	--	52,893	--	47,348
Department of Justice	--	--	--	--
Department of Commerce	19	--	1	--
Department of Agriculture	73	--	23	--
Government Printing Office	--	--	--	--
Library of Congress	--	--	--	--
Department of Veterans Affairs	--	--	--	--
National Security Agency	--	--	--	--
U.S. Postal Service	60	--	--	1
Total	\$ 4,598	\$ 1,268,206	\$ 3,181	\$ 1,356,216

Intra-governmental Amounts – Revenue and Costs

Budget Functions	2002		2001	
	Exchange Intra-governmental Revenue	Cost to Generate Exchange Intra-governmental Revenue	Exchange Intra-governmental Revenue	Cost to Generate Exchange Intra-governmental Revenue
Administration of Justice	\$ 114,082	\$ 116,438	\$ 94,221	\$ 99,680
General Government	264	264	264	264
Non-Exchange Revenue	2002		2001	
Partner Agency	In	Out	In	Out
Department of Defense	\$ 24	\$ --	\$ 2,484	\$ 5
Department of Justice	--	--	--	--
Department of Transportation	--	--	--	--
Department of State	--	--	77	--
General Services Administration	--	--	7	--
Federal Law Enforcement Training Center	--	--	7	19
Department of Agriculture	--	--	2	--
Federal Emergency Mgmt Agency	--	--	--	--
National Aeronautics & Space Admin	--	--	38	--
Department of Energy	--	--	38	--
Executive Office for Asset Forfeiture	10,236	--	37,310	--
Alcohol Tobacco and Firearms	--	--	--	--
Total	\$ 10,260	\$ --	\$ 39,963	\$ 24

Other Accompanying Information

Entity Receivables

An aging of entity receivables as of September 30, 2002 and 2001, is as follows (in thousands):

2002	Aged Period					
	<=90 days	91 days-1 year	1-2 years	2-3 years	3+ years	Total
Reimbursable services	\$ --	\$ 3,508	\$ 1,402	\$ 788	\$ 520	\$ 6,218
User fees	56,720	4,459	1,513	2,675	6,334	71,701
Gross receivables	56,720	7,967	2,915	3,463	6,854	77,919
Less uncollectible amounts	(6,511)	(238)	(159)	(238)	(794)	(7,940)
Net receivables	<u>\$ 50,209</u>	<u>\$ 7,729</u>	<u>\$ 2,756</u>	<u>\$ 3,225</u>	<u>\$ 6,060</u>	<u>\$ 69,979</u>

2001	Aged Period					
	<=90 days	91 days-1 year	1-2 years	2-3 years	3+ years	Total
Reimbursable services	\$ 2,861	\$ 43	\$ 10	\$ 3	\$ 11	\$ 2,928
User fees	63,992	603	3,038	945	2,405	70,983
Gross receivables	66,853	646	3,048	948	2,416	73,911
Less uncollectible amounts	(6,422)	(58)	(380)	(91)	(232)	(7,183)
Net receivables	<u>\$ 60,431</u>	<u>\$ 588</u>	<u>\$ 2,668</u>	<u>\$ 857</u>	<u>\$ 2,184</u>	<u>\$ 66,728</u>

Non-Entity Receivables

An analysis of the changes in accounts receivable during Fiscal Years 2002 and 2001 is as follows (in thousands):

2002	Receivables				
Receivable Category	Balance October 1	Recorded During the Fiscal Year	Collections	Write-offs	Balance September 30
Duties	\$ 814,454	\$19,815,633	\$ (19,643,228)	\$ (2)	\$ 1,007,504
Excise Taxes	40,060	2,199,053	(2,178,730)	--	59,964
Fees	62,000	1,570,734	(1,563,519)	(526)	68,949
Fines/penalties	485,675	9,904,714	(53,028)	(10,043)	382,588
Interest	47,295	61,778	(37,936)	(2,315)	66,361
Refunds and drawback	548	50,244	(261)	--	50,531
Totals	1,450,032	<u>\$33,602,156</u>	<u>\$ (23,476,702)</u>	<u>\$ (12,886)</u>	1,635,897
Less uncollectible amounts	(549,180)				(464,854)
Net receivables	<u>\$ 900,852</u>				<u>\$ 1,171,043</u>

2001		Receivables Recorded During the Fiscal Year	Collections	Write-offs	Adjustments	Balance September 30
Receivable Category	Balance October 1					
Duties	\$ 829,525	\$ 20,603,802	\$ (20,607,806)	\$ (9,564)	\$ (1,503)	\$ 814,454
Excise Taxes	40,300	2,074,369	(2,083,398)	(201)	8,990	40,060
Fees	65,228	1,573,401	(1,573,862)	(155)	(2,612)	62,000
Fines/penalties	737,326	2,103,466	(67,162)	(28,172)	(2,259,783)	485,675
Interest	57,302	72,509	(55,657)	(23,359)	(3,500)	47,295
Refunds and drawback	3,028	548	(3,028)	--	--	548
Totals	1,732,709	\$ 26,428,095	\$ (24,390,913)	\$ (61,451)	\$ (2,258,408)	1,450,032
Less uncollectible amounts	(784,195)					(549,180)
Net receivables	\$ 948,514					\$ 900,852

An aging of non-entity Intra-governmental receivables as of September 30, 2002 and 2001 is as follows (in thousands):

	Aged Period					
2002	<=90 days	91 days-1 year	1-2 years	2-3 years	3+ years	Total
Duties	\$ 894,529	\$ 42,659	\$ 19,850	\$ 13,402	\$ 37,064	\$ 1,007,504
Excise taxes	56,991	745	1,878	327	23	59,964
User fees	67,409	167	219	651	503	68,949
Fines/penalties	78,742	194,894	79,894	12,020	17,038	382,588
Interest	629	7,543	13,273	9,832	35,084	66,361
Refunds and drawback	243	43,879	6,366	--	43	50,531
Gross receivables	1,098,543	289,887	121,480	36,232	89,755	1,635,897
Less uncollectible amounts	(67,882)	(194,844)	(94,382)	(30,222)	(77,524)	(464,854)
Net receivables	\$ 1,030,661	\$ 95,043	\$ 27,098	\$ 6,010	\$ 12,231	\$ 1,171,043

	Aged Period					
2001	<=90 days	91 days-1 year	1-2 years	2-3 years	3+ years	Total
Duties	\$ 742,996	\$ 18,120	\$ 13,843	\$ 2,644	\$ 36,851	\$ 814,454
Excise taxes	38,267	978	793	--	22	40,060
User fees	60,149	224	1,108	3	516	62,000
Fines/penalties	128,373	256,612	63,959	14,288	22,443	485,675
Interest	591	5,463	8,907	956	31,378	47,295
Refunds and drawback	289	--	--	--	259	548
Gross receivables	970,665	281,397	88,610	17,891	91,469	1,450,032
Less uncollectible amounts	(112,552)	(260,818)	(75,782)	(14,927)	(85,101)	(549,180)
Net receivables	\$ 858,113	\$ 20,579	\$ 12,828	\$ 2,964	\$ 6,368	\$ 900,852

Customs Collections by Category

(Dollars in thousands)

	1998	1999	2000	2001	2002
Duties					
Consumption entries	\$ 18,537,332	\$ 18,405,248	\$ 19,857,605	\$ 19,272,396	\$ 19,485,864
Warehouse withdrawals	121,593	136,902	115,097	116,214	132,078
Mail entries	8,419	8,022	5,976	5,355	4,238
Passenger baggage entries	20,474	20,866	21,470	13,430	7,609
Crew baggage entries	105	100	100	54	36
Military baggage entries	51	37	34	17	18
Informal entries	31,209	40,590	45,102	48,472	49,911
Vessel repair entries	14,896	14,660	16,067	14,337	12,494
Other duties	384,058	428,968	494,450	343,574	95,695
Total Duties	<u>19,118,137</u>	<u>19,055,393</u>	<u>20,555,901</u>	<u>19,813,849</u>	<u>19,787,943</u>
Miscellaneous					
Violations of Customs law	56,554	56,089	111,703	66,082	55,789
Testing, inspecting & grading	32	25	31	38	35
Miscellaneous taxes	67,169	68,738	70,419	71,629	71,653
USDA collections	62,847	66,487	68,219	67,580	70,036
Harbor maintenance fee	645,023	551,146	673,324	706,763	673,348
Fees	2,488	2,368	2,916	3,011	4,774
User fee account	1,241,614	1,208,258	1,277,505	1,264,211	1,233,347
Unclaimed funds	1,529	2,175	850	790	1,337
Recoveries	30	27	56	89	30
Interest	26,900	31,437	38,603	56,080	15,389
Other Customs receipts	13,672	11,908	6,983	9,218	7,694
Total Miscellaneous	<u>2,117,858</u>	<u>1,998,658</u>	<u>2,250,609</u>	<u>2,245,491</u>	<u>2,133,432</u>
Internal Revenue Taxes	<u>1,171,844</u>	<u>1,351,749</u>	<u>1,541,419</u>	<u>1,694,097</u>	<u>1,913,752</u>
Total Collections	<u>\$ 22,407,839</u>	<u>\$ 22,405,800</u>	<u>\$ 24,347,929</u>	<u>\$ 23,753,437</u>	<u>\$ 23,835,127</u>

Total Collections include both custodial, duty, tax, fee and interest collections, and entity user fee collections recorded by port locations during the period October through September, as follows:

Custodial collections	\$ 22,071,957	\$ 22,132,062	\$ 24,049,336	\$ 22,484,774	\$ 22,605,492
Entity collections	335,882	273,738	298,593	1,268,663	1,229,635
Total Collections	<u>\$ 22,407,839</u>	<u>\$ 22,405,800</u>	<u>\$ 24,347,929</u>	<u>\$ 23,753,437</u>	<u>\$ 23,835,127</u>

Customs Collections by Major Processing Port Locations

(Dollars in thousands)

	1998	1999	2000	2001	2002
Boston	\$ 528,748	\$ 500,925	\$ 511,237	\$ 511,361	\$ 453,907
Buffalo-Niagara Falls	153,804	155,041	164,036	163,327	150,806
Ogdensburg	85,939	78,847	86,102	86,700	87,991
Portland, Maine	42,974	40,216	43,509	48,808	45,706
Providence	38,731	41,322	39,541	35,928	35,909
St. Albans	39,099	28,913	34,022	27,319	29,001
Baltimore	500,656	503,445	494,200	486,035	491,299
Philadelphia	500,449	525,247	545,958	522,816	539,610
New York	226,988	296,256	462,477	506,854	368,786
Newark	3,194,299	3,150,573	3,226,830	3,304,465	3,271,144
JFK Airport	1,329,737	1,293,669	1,474,054	1,221,749	1,255,133
Charleston	604,678	575,912	629,969	638,621	693,832
Miami	837,987	919,150	1,063,756	842,181	773,030
San Juan	125,822	115,908	105,467	104,714	185,885
St. Thomas	9,129	10,444	11,883	12,448	23,266
Savannah	640,669	659,185	752,055	817,331	835,753
Tampa	326,666	372,144	403,311	394,045	388,254
Wilmington	322,603	331,555	310,507	282,688	265,276
Norfolk	368,490	382,301	443,377	417,217	474,699
NFC Indianapolis/Washington	509,253	351,186	461,158	731,334	632,622
Mobile	64,367	61,324	92,364	80,691	93,955
New Orleans	834,440	761,820	797,544	764,649	776,773
Dallas/Ft. Worth	301,545	274,542	286,031	286,927	291,823
El Paso	107,708	103,953	75,033	75,844	68,121
Houston	464,907	437,079	472,332	485,334	516,549
Laredo	366,933	356,370	351,374	330,949	303,162
Port Arthur	31,178	28,035	29,097	27,255	33,466
Nogales	109,816	106,129	86,925	97,602	84,809
Los Angeles	4,499,699	4,616,494	5,183,813	5,101,101	5,291,462
San Diego	176,009	191,405	230,064	211,547	210,054
Anchorage	88,297	96,252	107,240	94,434	88,657
Honolulu	38,600	41,923	54,610	45,378	37,541
Portland	310,182	289,660	328,474	350,316	353,457
San Francisco	817,569	820,212	867,415	714,645	684,473
Seattle	642,053	713,242	845,930	799,770	783,326
Chicago	1,248,647	1,258,832	1,340,274	1,245,045	1,266,939
Cleveland	1,003,474	990,196	984,020	996,841	1,015,719
Detroit	438,979	430,802	447,904	388,553	396,886
Duluth	1,322	1,393	1,398	7,366	3,283
Milwaukee	45,794	40,967	36,396	33,894	32,876
Minneapolis	101,115	94,402	99,008	105,582	109,366
Pembina	9,990	10,941	11,497	11,743	11,786
St. Louis	237,332	231,650	257,673	265,855	268,592
Great Falls	90,801	96,049	107,613	106,416	103,760
Total Collections	22,417,478	22,385,911	24,357,478	23,783,678	23,828,744
Net Financial Statement Adjustments (a)	(9,639)	19,889	(9,549)	(30,241)	6,383
Total Revenues Collected	\$ 22,407,839	\$ 22,405,800	\$ 24,347,929	\$ 23,753,437	\$ 23,835,127

(a) Total collections represent collections recorded by the port locations during the fiscal year. Net financial statement adjustments primarily represent adjustments for timing differences for collections received during the fiscal year but not recorded until the next fiscal year.

Financial Management:
Report on Internal Control Over
Financial Reporting of the
U.S. Customs Service
For Fiscal Year 2002

OIG-03-033 December 16, 2002



Office of Inspector General



Office of
Inspector General

Department of the Treasury, United States Customs Service
Washington, D.C. 20229
December 16, 2002

MEMORANDUM FOR ROBERT C. BONNER, COMMISSIONER
UNITED STATES CUSTOMS SERVICE

FROM: William H. Pugh *William H. Pugh*
Deputy Assistant Inspector General
For Financial Management and Information Technology Audits

SUBJECT: Report on Internal Control over Financial Reporting of the U.S. Customs Service for Fiscal Year 2002

I am pleased to transmit the attached report on Internal Control over Financial Reporting of the U.S. Customs Service (Customs) as of and for the Fiscal Year (FY) ended September 30, 2002. We contracted with KPMG LLP, an Independent Public Accountant (IPA), to examine Customs' internal control over financial reporting. The IPA performed the examination in accordance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements Number 10 and generally accepted government auditing standards. The attachment includes the following:

- Independent Accountants' Report on Internal Control over Financial Reporting;
- Exhibit I – Material Weaknesses;
- Exhibit II – Reportable Conditions; and
- Exhibit III – Status of FY 2000 Findings Presented in the Inspector General's Report.

The IPA issued a qualified opinion on the internal control over financial reporting of Customs as of and for the FY ended September 30, 2002. The IPA qualified its opinion due to the following limitation of scope and four material weaknesses:

Limitation of Scope

Security clearance procedures and other matters, related to the access and handling of sensitive information, delayed the start of the information technology evaluation. This delay prevented the IPA from completing its testwork on information technology general and application controls.

Material Weaknesses (See Exhibit I of the Attachment.)

The IPA identified the following four material weaknesses as part of its examination:

- Customs did not adequately monitor the effectiveness of its internal controls over the entry duties and taxes in 2002.
- Drawback controls need to be strengthened.
- Customs information technology system logical access and software maintenance security controls need improvement.
- Core financial systems need to be improved and integrated (repeat condition).

Except for the effects of the limitation of scope and material weaknesses noted above, the IPA concluded that Customs maintained, in all material respects, effective internal control over financial reporting as of and for the year ended September 30, 2002, based on the Standards of Internal Control in the Federal Government, issued by the United States General Accounting Office. In addition, the IPA noted the following items, included in Exhibit II, which though not material weaknesses, are considered reportable conditions:

- Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.
- Customs did not adequately monitor movement of in-bond merchandise and did not measure the extent of compliance with Customs policies in 2002 (repeat condition).
- Internal control over the drawback process in New York/Newark was negatively affected by the events of September 11, 2001.
- Documentation of the entity-wide security program needs to be improved.
- There are internal control findings that affect Customs ability to comply with laws and regulations.

My staff's review of the IPA's working papers determined that the work was performed in accordance with generally accepted government auditing standards. Should you have any questions, please contact me at (202) 927-5430, or a member of your staff may contact Louis King, Director, Financial Audits at (202) 927-5774.



2001 M Street, N.W.
Washington, D.C. 20036

Independent Accountants' Report on Internal Control over Financial Reporting

Office of the Inspector General
United States Department of Treasury

The Commissioner
United States Customs Service:

We have examined the effectiveness of the United States Customs Service (Customs) internal control over financial reporting as of and for the year ended September 30, 2002, based on the *Standards for Internal Control in the Federal Government* (Standards), issued by the United States General Accounting Office (GAO) in November 1999. Customs management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Except as described below, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing, and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Customs operates an automated information technology system to assess, collect and report duties and excise taxes on merchandise entering the United States from foreign countries and to refund duties when imported merchandise is shipped out of the United States. Security clearance procedures and other matters, related to access and handling of sensitive information, delayed the start of the information technology evaluation and prevented us from completing our testwork on information technology general and applications controls. Consequently, we were also unable to verify whether information technology system controls exist that may mitigate the weaknesses in the design and operating effectiveness of internal controls over entry duties and taxes assessed, and drawback claims of duties collected.

Because of inherent limitations in any internal control, misstatements due to errors or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We noted certain matters, described in Exhibits I and II, involving internal control over financial reporting and its operations that we consider to be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Customs ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. We believe that the reportable conditions presented in Exhibit I are material weaknesses. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. A summary of the status of the Department of Treasury Office of Inspector General fiscal year 2000 reportable conditions is included as Exhibit III.

In our opinion, except for the effect of the material weakness described in Exhibit I on the achievement of the objectives of the control criteria defined in the Standards and the effect of matters we may have discovered had we been able to complete our testwork on information technology general and application controls, Customs maintained, in all material respects, effective internal control over financial reporting as of and for the year ended September 30, 2002, based on the Standards referred to above. We do not express an opinion or any other form of assurance on cost-benefit statements that may be contained in managements' response to our recommendations contained in Exhibits I and II.

This report is intended solely for the information and use of the Customs management, the Department of Treasury Office of Inspector General, Office of Management and Budget and U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

November 12, 2002

KPMG LLP

Exhibit I

Material Weaknesses

1. Customs did not adequately monitor the effectiveness of its internal controls over the entry duties and taxes in 2002.

Customs has adopted a “risk management based” approach to design and implement internal controls over trade compliance. It is not practical or cost effective to examine every shipment and entry document for all merchandise entering the United States and the Customs Modernization Act of 1993 placed the burden of compliance with trade laws, including the proper calculation and remittance of duty, on the importer. To execute the risk management based approach, Customs uses a multi-disciplinary network of employees in numerous mission specific operations, stationed in ports of entry throughout the United States and at national offices in Washington DC. These personnel have access to sophisticated computer and statistical tools and techniques that can be used to “target” imports for review and examination. Target criteria are developed based on an assessment of the risk of non-compliance with trade laws, including revenue assessment, and other mission related objectives, e.g. antiterrorism, contraband-enforcement. The target criteria are continuously refreshed and updated from analysis of historical and new information. Imports that pass the target criteria as well as other in-depth pre-entry analyses and automated system edits are allowed to enter the United States without further review. These imports are also subject to post-entry analysis conducted by staff in several different Customs operations. Use of targeting criteria is intended to optimize use of limited resources – dedicating inspector and specialist reviews in areas of greatest perceived benefit and/or minimization of risk. Significant reliance on the operating effectiveness of IT applications and other coordinated controls is a necessary component of this approach.

By design, the risk management based approach to internal control over entry does not subject every import to the same set of controls. Since imports are subjected to different controls, depending on the assessment of risk, a measurement of the overall effectiveness of the system of controls must be performed to provide reasonable assurance that the targeting process is achieving the intended results. Measurement of results and projection to the total population is essential to a system that depends on a sample to be representative of the whole.

In previous years, Customs used Compliance Measurement (CM) for this purpose. The CM program uses a statistical sampling method to select (i) import shipments for physical examination of the cargo and (ii) entry documents submitted by importers and brokers for detailed review. CM was designed principally as a measurement of control effectiveness. The results of CM reviews were compiled and used to project the overall compliance with U.S trade laws, regulations and agreements, and estimate a revenue gap (over/under vs. actual collections of revenue). The revenue gap calculation enabled financial management to monitor the effect of discrepancies on the financial statements and ultimately determine if revenue collections reasonably approximated those actually due.

However, after the events of September 11, 2001, CM was intentionally not performed during the majority of 2002 and consequently Customs lacks a statistically valid measurement of the effectiveness of its system of internal controls over the entire entry process for 2002. Inspections of merchandise and review of importer and/or broker submitted entry documentation performed in 2002 were non-statistical and judgmental, and could not be used to measure the overall extent of trade compliance. The lack of statistical measurement hinders Customs ability to determine the extent of Customs compliance with laws and regulations, and whether the duty collected materially approximates the amount that should have been collected (the revenue gap).

In addition, the weakness in logical access and software maintenance controls, described in material weakness #3 below, reduced the reliability of Customs automated system edits – a critical element of the entry control infrastructure. We also noted deficiencies in control activities performed by various port personnel that indicate a weakness in manual controls performed over entry, such as lack of documented authorization and untimely resolution of system edit report data.

The Inspector General’s fiscal year 2000 report described several weaknesses of the CM program for which we are unable to determine the status of corrective actions taken by Customs, if any (see Exhibit III).

Recommendations

The Standards for Internal Control in the Federal Government (Standards) issued by the General Accounting Office (GAO), state that “Internal control should generally be designed to assure that ongoing monitoring occurs in the

course of normal operations.” The Information and Communications section of the Standards, states that information should be recorded and communicated to and others within the entity who need it and in a form and timeframe that enables them to carry out their internal control and other responsibilities. It further states that for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events.

The Office of Management and Budget (OMB), Circular A-123, *Management Accountability and Control*, “management controls are the organization, policies, and procedures used by agencies to reasonably ensure that... reliable and timely information is obtained, maintained, reported and used for decision making.” Furthermore, “Federal managers must take systematic and proactive measures to develop and implement appropriate, cost-effective management controls.”

Also, OMB Circular A-123 requires agencies to establish and maintain a cost-effective system of internal controls to provide reasonable assurance that Government resources are protected against fraud, waste, mismanagement or misappropriation and that both existing and new program and administrative activities are effectively and efficiently managed to achieve the goals of the agency. All levels of management shall be involved in ensuring the adequacy of internal controls. Specifically, OMB A-123 states that financial managers must incorporate certain specific management control standards and ensure that transactions are promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports.

These standards are even more important to a process that (1) depends on voluntary compliance of thousands of importers and (2) uses sampling techniques to determine the extent of internal control to apply to individual transactions.

We recommend that Customs management reinstate a CM program that yields statistically valid results to quantify a revenue gap analysis and provide trade compliance results. If properly designed, the CM should provide a system of measurement to determine the effectiveness of controls over the entry process. The design should subject the entire population of cargo and entry summary documentation to examination and samples would be taken based on statistical sampling methodologies. The CM should address and

accomplish the objectives of control environment, risk assessment and monitoring.

We also recommend implementation of the recommendation in material weakness #3 to strengthen the reliability of the overall entry infrastructure.

Because the Customs CM program was suspended for the majority of 2002, we did not evaluate the program’s design and therefore, cannot conclude that re-instatement of CM used in previous years will completely accomplish these objectives.

2. Drawback controls need to be strengthened.

The Automated Commercial System (ACS) does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries or export documentation upon which the drawback claim is based. The ACS rejects drawback claims for verification when the amount of the claim is greater than the amount collected. However, the drawback module cannot electronically compare and determine whether duplicate drawbacks were claimed for merchandise at the invoice line-item level for previously claimed drawbacks. In addition, export information, a critical component of the drawback claim, is not currently available to be linked to the drawback module; and it prevents the electronic comparisons of export data within ACS.

Because comparisons of entry and export information cannot be performed electronically, Customs relies on a risk management based approach for controls over reviewing drawback claims. Since it is a risk management based approach, every drawback claim is not subject to the same level of review or internal controls.

Customs drawback risk management based selectivity process identifies drawback claims for review based upon first claim filings, random statistical hits, and a number of different criteria. Since drawback claims are subjected to different levels of review, depending on the assessment of risk, a measurement of the overall effectiveness of the system of controls must be performed to provide a reasonable assurance that the risk management based approach is achieving the intended results. Measurement and projection of the results to the entire population of drawback claims and the financial statements is essential to a system that depends on a risk management based methodology to controls.

Customs selective drawback processing methodology is designed to allow for the measurement and statistical projection of the results. However, Customs drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of system-selected consumption entries randomly selected for review, if they exceed thirty to a baseline of thirty items. This judgmental reduction in sample items tested impedes Customs ability to statistically measure and project the results of their drawback program.

Currently, criteria based selections, first claims and a five percent random selection of drawback claims are reviewed under the selectivity system. These items receive a full desk examination. Only those valued over \$50,000 are reconciled, a process requiring the examination of all related drawback claims. Furthermore, only the largest valued related import entry is required to be verified to all related drawback claims. Since only the largest valued related import entry against a selected drawback claim is verified, Customs is unable to determine whether, in the aggregate, an excessive amount was claimed. Since all of the related import entries are not reviewed and analyzed, errors and omissions could exist that would not be detected. Therefore, overall measurement and statistical projection of the results cannot be determined.

Recommendations

The Standards require that information be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities. The Standards also require that internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

In addition, OMB Circular A-123 management and accountability control requirements cited in material weakness #1 above apply equally to this drawback condition.

We recommend that Customs:

- Implement effective internal controls over drawback claims as part of any new systems initiatives;
- Revise current policies and procedures to provide a better statistical methodology to select items to review and reconcile all prior related import entries selected for review; and

- Ensure that the results of the drawback selectivity testing are monitored by measurement and statistically projected to determine the reasonableness of financial statement balances.

3. Customs IT system logical access and software maintenance security controls need improvement.

As mentioned in our Independent Accountants' Report, we were unable to complete our testwork on Customs information technology system general and applications controls due to delays caused by Customs security clearance procedures and other matters related to access and handling of sensitive information. Had we been able to complete our testwork, other matters may have been discovered that would have been reported to you.

Based on the procedures we were able to complete, we noted the following:

Network and host-based system configuration vulnerabilities exist that can potentially be used to compromise Customs system security. Also, Customs has not taken all necessary measures to ensure that required password policies, and procedures are implemented correctly. System vulnerabilities and ineffective password management practices can expose sensitive Customs resources to unauthorized use, loss, or modification. Without effective controls to ensure that access to systems is appropriately restricted to authorized employees, Customs is at risk that unauthorized persons could access sensitive applications and data.

We identified several other deficiencies in Customs logical access controls over its data files, application programs, and computer-related facilities and equipment. Such controls protect against unauthorized modification, disclosure, loss, or impairment.

We also noted that several vendor supplied software patches have not been installed. Some of the patches affect the system controls related to denial of service, privilege escalation, circumvention of access controls, and information disclosure.

Due to the sensitive nature of these matters, we have provided further details in a separate report with limited distribution.

Recommendations

The ISSB System Security Handbook states that individuals with access to Customs Systems must “choose hard to guess

but easy to remember passwords.” The NDC Z/OS Mainframe Infrastructure Security Design V1.1 documents states; “Users who access the mainframe via their LAN terminals must first logon to the Customs LAN using a different User ID and password.

The Information Systems Security Policy and Procedures Handbook, states that assurance should be provided that, (1) user IDs and passwords conform to the standard and (2) systems parameters are set in such a manner that passwords are prohibited from reuse for at least six generations, which means that a user cannot use the same password for at least six generations of password change. Users should be reminded of Customs password policy.

NIST Special Publication 800-14, Generally Accepted Principles and Practices for Securing Information Technology Systems, section 3.5.2 User Administration states that “Organizations should ensure effective administration of users’ computer access to maintain system security, including implementation and enforcement of effective user account password management practices.”

In addition, OMB Circular A-130, Appendix III – Security of Federal Automated Information Resources, states that agencies shall provide adequate security for all information processed, transmitted, or stored in Federal automated information systems. Of particular importance are technical and operational controls as part of management controls to prevent and detect inappropriate or unauthorized activities.

We recommend that Customs consider as part of Customs IT capital planning initiatives, improvement/migration IT strategies for current network and host-based system configurations to reduce likelihood that sensitive and critical Customs systems can be compromised.

We also recommend that Customs enforce stated password management policy and consider implementing the industry “best practice” recommendations on all Windows NT hosts to enhance security of the Customs IT infrastructure.

Customs should also enforce stated password management policy and consider implementing industry “best practice” recommendations on all Windows NT hosts to enhance security of Customs IT infrastructure. We recommend that Customs ensure that steps are taken to ensure that passwords are unique for each system.

We recommend that Customs restrict access to sensitive-related functions based on the least privilege concept to the minimum number of personnel with a defined and documented need. This would include a full review to determine the appropriate number of users that should have system security administrator access with centralized privileges, removal of duplicate and inactive accounts and others with multiple privileges.

We also recommend that the most current operating system patches be installed on all systems. In the event that operational issues in application systems preclude installation of such patches, Customs should consider development of a migration strategy to replace applications for greater security of the operational environment. Patches are issued to address critical problems in the Network Operating System as well as addressing high-risk security vulnerabilities discovered in operating systems. Without these patches, an attacker could use known vulnerabilities to gain unauthorized access to the affected systems.

4. Core Financial Systems Need To Be Improved and Integrated (repeat condition).

Customs core financial systems did not provide certain financial information necessary for managing operations. Also, the financial systems did not capture all transactions as they occurred during the year, did not record all transactions properly, and were not fully integrated. Additionally, the systems did not always provide for essential controls with respect to override capabilities. As a result, extensive manual procedures and analyses were required to process certain routine transactions and prepare year-end financial statements.

Weaknesses in the core financial systems, some of which are repeat findings, and specific recommendations are discussed below:

- ***Automated Commercial System (ACS) Accounts Receivable Subsidiary Ledger*** – We noted that the ACS system cannot provide summary information on the total unpaid assessments for duties, taxes, and fees by an individual importer. Also, ACS does not generate periodic management information on outstanding receivables, the age of receivables or other data necessary for managers to effectively monitor collection actions. Customs also must utilize ad hoc reports and manual procedures to ascertain and adjust certain year-end accounts receivable balances. Collectively, these conditions increase the likelihood that an error would occur and not be detected.

Recommendation

The Joint Financial Management Improvement Program's (JFMIP) Core Financial System Requirements, states that the core financial system must maintain detailed information by account sufficient to provide audit trails and to support billing and research activities. Together with the design of Customs new accounting system or as Customs makes normal enhancements to the current IT systems and processes and once management has considered the cost/benefit trade-off of system enhancements, we recommend that Customs consider adopting a "customer-based" accounts receivable subsidiary ledger that is capable of aging the accounts and that interfaces with the general ledger system.

- **Cost Accounting** – The Cost Management Program, Customs primary control used to implement, maintain and manage improvements to the Cost Management Information System (CMIS), did not report cost information on a regular basis throughout fiscal year 2002. This is because core financial systems were not integrated to enable financial personnel to capture and analyze cost information for fiscal year 2002 at their lowest levels without the use of the annual survey process, which Customs has relied upon in previous years. Additionally, Customs currently produces cost management information only at year-end. Cost management information should be produced on a regular basis throughout the fiscal year to provide management with relevant and timely information upon which to base operational decisions.

Recommendation

The JFMIP's Core Financial System Requirements, states that the core financial system must support managerial cost accounting by providing (i) the capability to measure and report the costs of each segment's outputs and (ii) complete, reliable, consistent, timely and useful financial management information on operations to enable central management agencies, individual operating agencies, divisions, bureaus, and other sub-units to carry out their fiduciary responsibilities. It further states that the core financial system must support the ability to capture fees and other charges imposed by the agency for services and things of value it provides. These costs should be captured at the lowest level to reflect actual costs incurred by the agency in providing goods and services.

We recommend that Customs management integrate financial systems to enable them to eliminate the survey process and report cost information on a periodic basis throughout the year. Management has reported that the interface from source legacy systems, including COSS was integrated in the SAP database in October 2002 that will enable CMS to eliminate the survey process and report cost information on a monthly basis in 2003.

- **Recording Certain Transactions In The General Ledger System** – Certain transactions are not properly recorded in the general ledger system as they occur. Customs did not program its general ledger system, specifically the Asset Information Management System (AIMS) to properly record transactions for financial reporting purposes. For example, the AIMS is programmed to record all transactions as an appropriated transaction, including those that should be recorded as a non-appropriated transaction. Reimbursable transactions may be recorded as though they were an appropriated transaction when in fact they were reimbursable transactions. In addition, Customs is unable to record a liability in the general ledger upon receipt of goods or services. Because the system was not programmed for financial reporting purposes certain transactions are not recorded in a timely manner, e.g. accounts payable were not established and related obligations were not liquidated in the system in a timely manner. Additionally, Customs is required to create numerous adjusting journal entries, monthly, quarterly, and annually and manual reversing entries to compensate for the limitations in AIMS.

Recommendation

Section 7 of OMB Circular A-127, *Financial Management Systems* requires that financial events be recorded by agencies throughout the financial management system applying the requirements of the U.S. Government Standard General Ledger (SGL) at the transaction level. It further states that the criteria (e.g., timing, processing rules/conditions) for recording financial events in all financial management systems shall be consistent with accounting transaction definitions and processing rules defined in the SGL. In addition, the JFMIP's *Framework for Federal Financial Management Systems*, Chapter 3, states that financial event processing covers those mechanisms necessary to properly process and track data on financial events. It further states that the system shall support activities associated with establishing payables and disbursing funds.

We recommend that Customs comply with applicable sections of OMB Circular A-127 and JFMIP, by properly recording all transactions in the general ledger as they occur.

- **Systems Integration** – We noted that the CARMAC (aircraft parts) and CAMITS (marine parts) are both contractor owned systems that are not fully interfaced with the AIMS (Customs general ledger system), which cause timing differences in reporting information during the year. Because the systems are not interfaced, inventory purchases and payments are not accurately applied during the year. Purchases of aircraft and marine parts are reconciled to AIMS on a quarterly basis; however the payments are recorded in AIMS on a bi-weekly basis. Except for the quarterly adjustments AIMS does not accurately reflect inventory balances and activity at any time throughout the year.

We also noted that the Property Information Management System (PIMS) utilized to account for and track personal property, was not fully integrated with the Asset Management Information System (AIMS).

Recommendation

With the implementation of SAP Release 2 on October 1, 2003, replacing PIMS with the Asset Accounting (AA) module of SAP R/3, some of these matters are expected by management to be addressed and corrected. We recommend that Customs consider interfacing CARMAC and CAMITS with AIMS/SAP when implemented. We recommend Customs ensure that PIMS and AIMS/SAP when implemented are fully integrated.

Exhibit II

REPORTABLE CONDITIONS

5. Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.

Customs has a nationally mandated policy that requires periodic operator compliance reviews of operators of bonded warehouses and foreign trade zones (FTZ). The ability of Customs to monitor the quantity and type of goods moving in and out of bonded warehouses and FTZ's, and eventually collecting proper duties, is reliant on the performance of the operators in maintaining compliance with Customs policies and procedures.

In several port locations, reviews of bonded warehouse and FTZ operators were not performed and in other locations these reviews were substantially curtailed. When reviews were conducted, the extent of review was often locally determined and dependent on available resources, which varied by port. We also noted inconsistent documentation and follow-up on bonded warehouse and FTZ operator reviews that were conducted during 2002 and in previous years. Findings were reported to the operators without a clear schedule of expected corrective actions, timing and expected post-review procedures.

Recommendations

The Standards state that:

- "Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved;"
- "Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved," and
- "Program managers need both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources."

We recommend that Customs management perform periodic spot-check inspections of bonded warehouses and foreign trade zone operators. A standard national checklist should be used while conducting the reviews to ensure that reviews

are performed consistently throughout the United States and findings and recommendations can be used to refresh the reviews. Specific corrective action plans or advisory reports should be provided to the operator, together with an expected timetable for correction of findings. Finally, Customs should make periodic follow-up reviews to assess the progress made on corrective action plans until the findings have been adequately addressed.

6. Customs did not adequately monitor movement of in-bond merchandise and did not measure the extent of compliance with Customs policies in 2002 (repeat condition).

In the ports subject to examination, we noted that the Inspectors do not always verify the quantity and type of cargo prior to the in-bond movement. In some situations the reports of movements did not match the arrived-at-destination reports. System and procedural limitations can complicate or even prevent adequate reconciliation and matching of movements. For example, Customs policy does not require carriers to submit exportation documentation; rather, they are required to notify Customs of exportation. This creates an opportunity for cargo designated as exportation to be entered as a portion of an entry made for a separate shipment. In some locations we visited, we noted conflicting information regarding the description of the unit of measure from the originating and destination ports, which generated unmatched quantities in ACS. Reports of overdue in-bond shipments showed that a number of in-bond movements were overdue or undelivered and the overdue in-bond movements were not always resolved in a timely manner, including those coded for exportation.

We also noted that Customs uses a compliance measurement program within the “Tinman” In-bond Module, which is similar to the CM program used in the entry process, to select, review and determine overall compliance of in-bond movements. However, this portion of Tinman was suspended during fiscal year 2002 to allocate resources to other mission related objectives. Customs performed some in-bond testing at the end of fiscal year 2002, however the tests were inconclusive. Thus Customs was unable to reliably measure over-all compliance with its in-bond policies.

Recommendations

The Standards state that:

- “Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved;”

- “Monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved,” and
- “Program managers need both operational and financial data to determine whether they are meeting their agencies’ strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources.”

Because Customs assesses the appropriate duty calculation after in-bond movements occur and merchandise reaches its final destination, it is important that these movements be closely monitored. We recommend that Customs management improve the control environment by:

- Developing and implementing policies and procedures regarding tracking and closing of in-bond movements, and
- Reinstating compliance measurement audits over the in-bond movement process.

7. Internal Control over the drawback process in New York/Newark was negatively affected by the events of September 11, 2001.

On September 11, 2001 the Customs New York City drawback office was completely destroyed along with all hard copy documentation related to the drawback process. Customs revised drawback-processing procedures for the drawback office that superseded the traditional full-desk review and selective drawback processing procedures that are currently in effect nationally. The selectivity based full-desk review performed prior to September 11, 2001 included review and analysis of original hard copy supporting documentation. The supporting documentation reviewed included proof of export and related consumption entry information. The documentation required for a full-desk review performed subsequent to September 11, 2001 is limited to ACS system information that is not supported by original hard copy documentation. The following findings are noted as they relate to the new procedures established in the New York/Newark drawback office based on the events of September 11, 2001.

- Customs did not implement procedures with respect to liquidating drawback claims of \$250,000 or more. Approximately 30 Drawback claims are currently in suspense and another 117 drawback claims greater than \$250,000 are in the ACS system and will be available for liquidation. Until liquidation procedures are implemented those claims available for liquidation will remain open. It should be noted that not all of these drawback claims in suspense are available for liquidation.

- The self-inspection program was suspended for fiscal year 2002. Customs could not effectively complete this program due to the total loss of documentation required for the review. This self-inspection program was used as an internal control over liquidated drawbacks claims to mitigate the risk that a drawback initially reviewed under the selectivity process was improperly performed.
- Customs does not verify all drawback claims selected for review amounts less than \$250,000 to original consumption entries filed in New York prior to September 11, 2001. The New York/Newark office will only reconstruct paper documentation for claims selected for review that are found discrepant in a desk review. Non-discrepant claims are not verified to the paper documentation as they would be in other drawback offices. These drawback claims are subject to the random drawback selectivity process, however since the documentation was completely destroyed Customs is unable to complete required the drawback selectivity testing over these items.

Recommendations

The Standards require that internal control activities be performed to help to ensure that management's directives are carried out. Internal control should also provide for an assessment of the risks that the agency faces from both external and internal sources. The Standards also require that management identify risks and perform appropriate risk assessments. All significant interactions between the Customs and the drawback claimants as well as internal factors at both the entity wide and activity level should be considered. This includes Customs determination of the assessment of risk over each claimant for the possibility of the submission of excessive drawback claims.

We recommend Customs:

- Implement the procedures to liquidate drawback claims of \$250,000 or more;
- Implement a self-inspection program in New York/Newark; and
- Examine alternative approaches to strengthen controls over subsequent drawback claims where documentation is no longer available.

8. Documentation of The Entity-Wide Security Program Needs To Be Improved.

As mentioned in our Independent Accountants' Report, we were unable to complete our testwork on Customs information technology system general and applications controls due to delays caused by Customs security clearance procedures and other matters related to access and handling of sensitive information. Had we been able to complete our testwork, other matters may have been discovered that would have been reported to you.

Supporting documentation in the NDC Mainframe Systems Accreditation Package contained inaccuracies and incomplete/unclear process descriptions. We noted the following:

- Deficiencies with the NDC Z/OS Mainframe Infrastructure Security Test Plan and Infrastructure Security Requirements;
- Inaccuracies in the NDC Z/OS Mainframe Infrastructure Security Features User Guide; and
- Incomplete process descriptions and documentation in the NDC Z/OS Mainframe Infrastructure Trusted Facility Manual.

With inaccurate and unclear/incomplete process definitions in certification and accreditation documents, there is an increased likelihood for those processes to be either omitted or not implemented as intended in referenced and subordinate documentation.

Recommendation

NIST FIPS Pub 102, Guideline for Computer Security Certification and Accreditation, states that "Security certification is a technical evaluation for the purpose of accreditation, and uses security requirements as the criteria for that evaluation; security accreditation is management's approval for operation, and is based on that technical evaluation and other management considerations." "Security requirements are expressed in increasing detail as one progresses from high-level general descriptions of the system through lower levels of detailed specification. Evaluation for security certifications focuses on the determination of compliance with security requirements".

We recommend that the deficiencies and inaccuracies be identified and corrected. Certification and accreditation documentation package for the mainframe infrastructure should be reviewed for inaccuracies and incomplete process definitions, and corrected. Process documentation should be clear, complete and current in all NDC Z/OS manuals.

9. Internal Control Findings that Affect Customs Ability to Comply with Laws and Regulations.

The following represent our findings on the internal controls over processes that affect compliance with laws and regulations.

- **Cost Management (repeat condition)** – Customs has not corrected a finding identified in the fiscal year 2000 OIG report related to reporting on user fees and all fees it imposes for services and things of value in accordance with the CFO Act. and 19 U.S.C. § 58c.(f)(4). These reporting requirements are on a biennial basis, with fiscal year 2002 being the next opportunity to report. In a follow-up memo dated March 15, 2002, OIG determined that Customs remained in a noncompliance situation and is now also in noncompliance with 31 U.S.C. § 902(a)(8).

A review of COBRA and user fees and related costs for fiscal year 2000 was completed in 2001. Overall recommendations indicated that legislation would be required to amend the fees to better match actual costs. In February 2002, the User Fee Working Group recommended that legislation be introduced to revise user fees to reflect actual costs related to providing the services, however, specific fee recommendations were not made for the each activity. Customs user and COBRA fees do not appropriately match related costs.

Recommendation

Regulation 19 U.S.C. § 58c.(f)(4) states; “At the close of fiscal year 1988 and each even-numbered fiscal year occurring thereafter, the Secretary of the Treasury shall submit a report to the Committee on Ways and Means of the House of Representatives and Committee on Finance of the Senate regarding the fees imposed under... 58c.(a)...(other than the excess fees determined by the Secretary under paragraph (5)) should be adjusted in order that the balance of the Customs User Fee Account approximates a zero balance.”

We recommend that Customs management (1) issue the report to Congress regarding COBRA fees for fiscal year 2002 and (2) review user fees for fiscal year 2002 and make recommendations regarding the fees versus related costs. Based on discussions with the Cost Management group management, the review of user fees for fiscal year 2002 will be finalized in fiscal year 2003. The Cost

Management group management also noted that a draft of the report required pursuant to 19 U.S.C. 58c(f)(4) for fiscal year 2002 has been drafted and is in its initial review stages. We recommend that the Customs consult with the General Counsel’s office for specific compliance instructions wherever the law is subject to varied interpretation.

- **Individual Transaction Plan** – We noted that several contracts over \$100,000 did not contain an Individual Transaction Plan (ITP), as required by the Department of Treasury Acquisition Regulations (DTAR). Based on discussions with Custom management it appears that the Customs Procurement Services misinterpreted the FAR and did not believe an ITP was required for personal services contracts over \$100,000. Accordingly, Customs is not in compliance with the Department of Treasury Acquisition Regulations FAR, Part 7.

Recommendation

According to the FAR, Part 7, “a written plan is required for each commercial source acquisition exceeding the simplified acquisition threshold (inclusive of all options and term extensions).” The simplified acquisition threshold is \$100,000. Plans are to be retained in the contract file, and updated for significant changes. We recommend Customs prepare an ITP for all contracts over \$100,000.

Exhibit III

U.S. Customs Service
STATUS OF FISCAL YEAR 2000 FINDINGS PRESENTED IN THE INSPECTOR GENERAL'S REPORT
 September 30, 2002

FY 2000 Report Reference	FY 2000 Condition	Status
Material Weaknesses:		
1.	<i>Core Financial Systems Need to be Improved and Integrated</i>	Repeated Comment See Material Weakness #4
2.	<i>Effort to Ensure the Timely Restoration of Mission-Critical Systems Need to be Accelerated</i>	Unable to verify status due to limitation in the scope of our work.
Reportable Conditions:		
3.	<i>Drawback Controls Need to be Strengthened</i>	See Material Weakness #2
4.	<i>Compliance Measurement Programs Need to be Comprehensively Implemented to Identify the Revenue Gap and Assess Trade Law Compliance</i>	Partially Repeated Comment See Material Weakness #1 and Reportable Condition # 5 Partially unable to verify status due to limitation in the scope of our work.
5	<i>Controls over In-bond Shipments Need to be Strengthened</i>	Repeated Comment See Reportable Condition # 6
6.	<i>Entity-Wide Security Program Planning and Management Needs to be Improved</i>	Unable to verify status due to limitation in the scope of our work. See related Reportable Condition #8
7.	<i>Physical and Logical Access Controls Need to be Improved</i>	Unable to verify status due to limitation in the scope of our work. See related Material Weakness #3
8.	<i>Software Development and Change Controls need to be Fully Implemented for Legacy Applications and/or Systems</i>	Unable to verify status due to limitation in the scope of our work.

For a complete description of reportable conditions, including material weaknesses, noted in fiscal year 2000, see the U.S. Department of Treasury Office of Inspector General's report entitled; *FINANCIAL MANAGEMENT: Audit of the United States Customs Service's Fiscal Years 2000 and 1999 Financial Statements* (Report No. OIG-01-045, dated February 23, 2001).

Acronyms

ACE	Automated Commercial Environment	DOD	Department of Defense
ACH	Automated Clearinghouse	DSO	Drug Smuggling Organization
ACS	Automated Commercial System	EastPac	Eastern Pacific Ocean
ACSI	Americas-Counter Smuggling Initiative	eCP	Electronic (e) Customs Partnership
AD/CV	Antidumping/Countervailing	ECS	Express Consignment Service
ADP	Automated Data Processing	EEO	Equal Employment Opportunity
AES	Automated Entry System	EFT	Electronic Funds Transfer
AMICC	Air and Marine Interdiction Coordination Center	FAA	Federal Aviation Administration
APIS	Advance Passenger Information System	FASAB	Federal Accounting Standards Advisory Board
ATD	Applied Technology Division	FBI	Federal Bureau of Investigation
ATF	Bureau of Alcohol, Tobacco, and Firearms	FCIP	Federal Career Intern Program
ATS	Automated Targeting System	FECA	Federal Employees' Compensation Act
ATS-P	Automated Targeting System – Passenger	FEGLI	Federal Employees' Group Life Insurance
BASC	Business Anti-Smuggling Coalition	FEHBP	Federal Employees' Health Benefits Program
BMPE	Black Market Peso Exchange	FDA	Federal Drug Administration
BSA	Bank Secrecy Act	FERS	Federal Employees' Retirement System
C3	Customs CyberSmuggling Center	FFMIA	Federal Financial Management Improvement Act
CAFC	Court of Appeals for the Federal Circuit	FIS	Federal Inspection Service
CAPPS	Customs Automated Port Profile System	FLETC	Federal Law Enforcement Training Center
CBT	Computer Based Training	FMFIA	Federal Managers' Financial Integrity Act
CCRA	Canada Customs and Revenue Agency	FinCEN	Financial Crimes Enforcement Network
CEU	Continuing Education Units	FY	Fiscal Year
CFO	Chief Financial Officer	GAAP	General Accepted Accounting Principles
CIC	Citizenship and Immigration Canada	GAO	General Accounting Office
CIP	Carrier Initiative Program	GMRA	Government Management Reform Act
CLI	Customs Leadership Institute	GPRA	Government Performance and Results Act
CMC	Customs Management Center	GS	General Schedule (Pay Scale)
CMM	Capability Maturity Model	GSA	General Services Administration
CMO	Customs Modernization Office	HIDTA	High Intensity Drug Trafficking Area
CMP	Compliance Measurement Program	HIFCA	High Intensity Financial Crime Area
COBRA	Consolidated Omnibus Budget Reconciliation Act	HRM	Human Resources Management
COMPEX	Compliance Measurement Examination	IACET	International Association for Continuing Education and Training
COTS	Commercial Off-the-Shelf	IAFIS	Integrated Automated Fingerprint Identification System
CRF	Commercial Recovery Facility	IBET	Integrated Border Enforcement Team
CSI	Container Security Initiative	ICCS	International Crime Control Strategy
CSRS	Civil Service Retirement System	ICDE	Interagency Crime and Drug Enforcement
CTP	Customs Tuition Program	INS	Immigration and Naturalization Service
C-TPAT	Customs Trade Partnership Against Terrorism		
DCL	Dedicated Commuter Lanes		

IPR	Intellectual Property Rights	OTD	Office of Training and Development
IRMCO	Interagency Resources Management Conference	PAU	Passenger Analytical Unit
IRS	Internal Revenue Service	PDAT	Passenger Data Analysis Team
ISA	Importer Self-Assessment Program	POE	Port of Entry
ISSB	Information Systems Security Branch	PRD	Personal Radiation Detectors
ITAR	International Traffic in Arms Regulations	PSR	Passenger Service Representative
JFK	John Fitzgerald Kennedy	PTDP	Professional Trainer Development Program
JTTF	Joint Terrorism Task Force	PFI	Primary Focus Industry
K-9	Canine (dog)	RAIC	Resident Agent in Charge
LBVTS	Land Border Vehicle Targeting System	S&E	Salaries and Expenses
LAT	Local Assistance Training	SAP R/3	Integrated Financial Systems Software
LEO	Law Enforcement Officer	SAIC	Special Agent-In-Charge
LPR	License Plate Reader	SBA	Shared Border Accord
MDMA	3,4-Methylenedioxyamphetamine	SCF	Standard Curriculum Frameworks
MEO	Marine Enforcement Officer	SEACATS	Seized Asset and Case Tracking System
MSPB	Merit Systems Protection Board	SED	Shipper's Export Declaration
MTD	Major Transactional Discrepancies	SENTRI	Secure Electronic Network for Travelers Rapid Inspection
NAFTA	North American Free Trade Agreement	SF	Standard Form (Example: SF-50)
NCAP	National Customs Automated Prototype	SFFAS	Statement of Federal Financial Accounting Standard
NCIC	National Criminal Information Center	SHIMS	Safety and Health Information Management System
NFC	National Finance Center	STC	Strategic Trade Center
NICB	National Insurance Crime Bureau	STL	State and Local
NII	Non-Intrusive Inspection	TSN	Trade Support Network
NTEP	National Training Evaluation Program	TECS	Treasury Enforcement Communications System
NTP	National Training Plan	TFF	Treasury Forfeiture Fund
OBS	Office of Border Security	TPVT	Textile Production Verification Team
OCDETF	Organized Crime Drug Enforcement Task Force	Treasury	Department of the Treasury
ODTC	Office of Defense Trade Controls	TSN	Trade Support Network
OF	Office of Finance	UOF	Use of Force
OFO	Office of Field Operations	U.S.	United States
OIG	Office of Inspector General	U.S.C.	United States Code
OIT	Office of Information and Technology	USDA	United States Department of Agriculture
OMB	Office of Management and Budget	USPS	United States Postal Service
ONDCP	Office of National Drug Control Policy	VACIS	Vehicle and Cargo Inspection System
OPAC	On-line Payment and Collection System	VIN	Vehicle Identification Number
OPEB	Other Post-Employment Benefits	VIS	Vehicle Identification Specialist
OPM	Office of Personnel Management	WMD	Weapons of Mass Destruction
ORB	Other Retirement Benefits	WTC	World Trade Center
ORR	Office of Regulations and Rulings		
OST	Office of Strategic Trade		



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